LCBO

ANNUAL REPORT 2002–03

Our eighth straight record year

The LCBO 2002–03 Annual Report

Under the *Liquor Control Act*, we are required to prepare an annual report to the Minister of Consumer and Business Services. The Minister submits the report to Cabinet and tables it in the Provincial Legislature. This document is first and foremost a formal record of the LCBO's financial performance for the past fiscal year; however, it also provides an overview of the Ontario beverage alcohol marketplace.

Contents

Members of the LCBO Board (during fiscal 2002–03)

Andrew S. Brandt, *Chair and Chief Executive Officer*

John Hopper, *Vice Chair; Member, Audit and Governance Review Committee*

Thom A. Bennett, *Member; Chair, Audit and Governance Review Committee*

Gayle Christie, *Member; Member, Audit and Governance Review Committee*

Bev Hammond, *Member*

Dr. Merle A. Jacobs, *Member*

Perry Miele, *Member*

John S. Lacey *(Vice-Chair; Member, Audit and Governance Review Committee; term expired June 2002)*

Bob Peter, *President and Chief Operating Officer*

Letter of Transmittal

The Hon. Tim Hudak
Minister of Consumer and Business Services

Dear Minister,

I have the honour to present you with the 2002–03 Annual Report of the Liquor Control Board of Ontario.

Respectfully submitted,

Andrew S. Brandt
Chair and Chief Executive Officer

Credits

The LCBO wishes to thank the Office of the Provincial Auditor and the members of the Audit and Governance Review Committee of the Board for their assistance in preparing this document.

Produced by LCBO Corporate Communications.

Financial information prepared by LCBO Financial Planning & Development. French adaptation by LCBO French Language Services.

Ce rapport est également publié en français sous le titre : Rapport annuel de la LCBO 2002–03.

Minister's Message

As Minister of Consumer and Business Services, with responsibility for the LCBO, I am pleased to provide you with the LCBO Annual Report for the fiscal year 2002–03.

The LCBO has once again fulfilled its mandate in fiscal 2002–03 by:

- providing excellent service and product selection in improved shopping environments
- maximizing its dividend to the taxpayers and Government of Ontario, transferring a record $975 million, not including taxes, to support this government's programs and services
- continuing to improve operational efficiencies
- and taking a leadership role in promoting the socially responsible use of beverage alcohol.

In fiscal 2002–03, the LCBO also helped Premier Ernie Eves' government achieve its policy objectives in two key areas: support of the Ontario wine industry and expansion of the agency store program.

As you'll note on page 32, the LCBO worked with the government and the Ontario wine industry to develop and implement a number of initiatives to help consumers learn more about Ontario wines. Every bottle of Ontario wine sold in LCBO stores, and through other outlets such as winery retail stores and licensed establishments, helps strengthen our province by providing jobs at wineries and in ancillary industries ranging from grape growing to tourism. We expect the ongoing collaboration between government, the LCBO and the wine industry will continue to build the market share of Ontario wines in the years to come.

In the fall of 2001, our government announced an expansion of the agency store program (page 36), a public-private partnership that has been in existence since 1962. Our goal was to improve beverage alcohol service in communities too small to support a regular LCBO or Beer Store outlet, and help these communities strengthen their economic bases by encouraging residents and visitors to shop locally. The network expanded by some 50 stores in fiscal 2002–03 and will expand by another 66 in fiscal 2003–04, benefitting under-serviced communities, small business owners and their customers.

As you read this report, you will note many other ways in which the LCBO serves the people of Ontario:

- by keeping beverage alcohol out of the hands of minors and people who appear intoxicated
- by advertising against impaired driving with partners such as MADD Canada
- by protecting the health of Ontario consumers through extensive product testing at its Quality Assurance laboratory
- by raising hundreds of thousands of dollars a year for charitable causes
- and by helping communities cover costs associated with recycling beverage alcohol containers through municipal Blue Box programs.

As an operational enterprise of the provincial government, the LCBO must meet not only the government's expectations but also those of its shareholders, the citizens of Ontario. As the Minister responsible, I have encouraged and worked with the LCBO to meet and hopefully exceed these expectations, and by many measures it has done so.

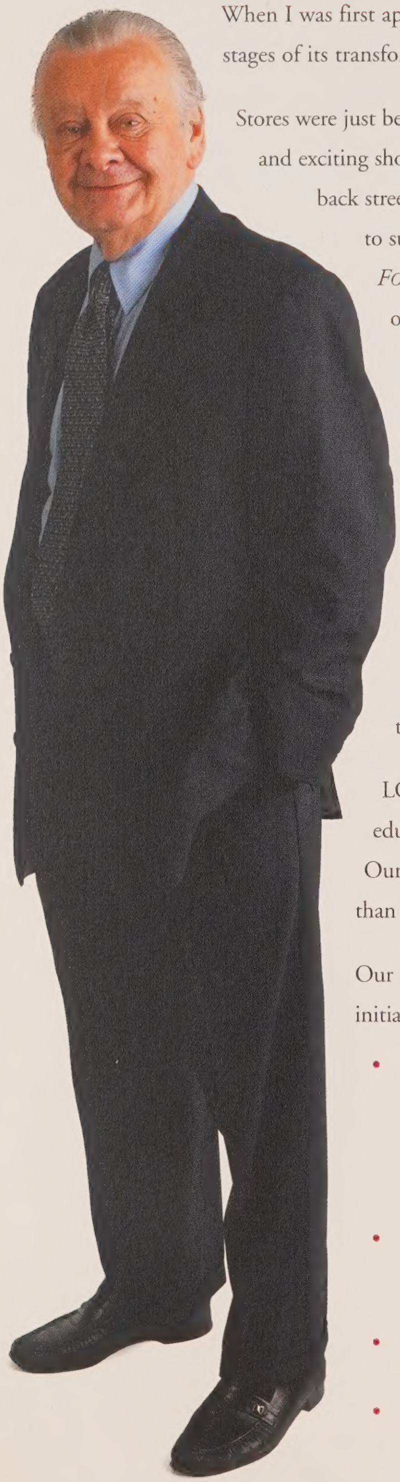
I will continue to work closely with the LCBO Board, employees and trade partners – along with my colleagues in government and staff – to ensure this public asset continues to be well managed and the Ontario public continues to be well served. In this regard, the LCBO's new *Discover the World* five-year plan provides a clear roadmap for further progress and enhanced customer service.

Sincerely,

Tim Hudak
Minister of Consumer and Business Services

Chair's Message

With our new five-year plan, a seasoned senior management team, a strong Board and the ongoing support of government, LCBO employees are poised to meet and exceed stakeholder expectations in fiscal 2003–04 and beyond



When I was first appointed Chair and CEO of the LCBO in February 1991, the organization was still in the early stages of its transformation from control-oriented distributor to customer-focused retailer.

Stores were just beginning to undergo a much-needed modernization from drab, poorly located outlets to appealing and exciting shopping environments. Backed by market research and analysis, we started moving more stores from back streets to more accessible and convenient locations. We expanded our selection to include products to suit every budget and taste. New marketing initiatives, such as the popular consumer magazine *FOOD & DRINK*, helped us position beverage alcohol as part of a balanced lifestyle. Employees developed their product knowledge and service skills so they could better inform customers about the products we sell. Social responsibility campaigns were developed and delivered to deter underage purchases and impaired driving.

Change wasn't always easy. As in many organizations, it required a shift in culture. But with the right tools, training and leadership, our employees were able to embrace and adapt to change.

Now in my fifth term, I oversee an entirely different LCBO: a modern retailer often cited by others as a model government enterprise; the winner of more than 100 awards in the past decade for store design, retail innovation, social responsibility, employee development, marketing and communications; confident in its ability to provide outstanding customer service; proud of the contributions it makes to communities across Ontario and to government coffers.

LCBO employees have delivered eight straight record dividends to the government, to help fund education, health care and other important government social programs, services and capital projects. Our dividend for fiscal 2002–03 – $975 million, which does not include taxes – is $70 million higher than last year and $360 million higher than it was a decade earlier.

Our dividend alone is a strong indicator of the success we enjoyed in fiscal 2002–03. The following initiatives and accomplishments illustrate our success in other areas.

- For the third straight year, we challenged more than 1.1 million would-be customers because they appeared underage or intoxicated; nearly 70,000 were refused service. We also partnered with MADD Canada on a TV commercial that encouraged people to stop their friends from drinking and driving, and developed other materials to encourage people who drink to do so responsibly (page 40).
- We worked with partners in government and the Ontario wine industry on numerous initiatives to promote Ontario wine sales in our stores and build the domestic industry's share of the Ontario market (page 32).
- We expanded the agency store program to improve customer service – and local economies – in smaller communities that can't support a regular LCBO store or Beer Store (page 36).
- We upgraded and automated two of our five warehouses to improve product flow and service to stores, and developed plans to expand our facility in London to nearly double its throughput and storage capacity (page 39).

- We expanded, renovated or relocated more than 50 stores – including our flagship Summerhill store – to offer customers a more appealing and informative shopping experience and provide a solid return on our capital investment (page 34).
- We worked with suppliers to improve product sales forecasting and replenishment practices (page 38).
- We held our first-ever commercial wine auction, offering collectors, connoisseurs, licensees and other enthusiasts the opportunity to buy – or sell – some of the world's finest wines.
- We upgraded our point-of-sale and sales audit systems to meet the needs of today's fast-paced retail environment and improve the integrity of sales data transmitted to Head Office.

Over the next five years we will build on this success, guided by a new five-year strategic plan designed to maximize growth and minimize risk through fiscal 2007–08.

Since 1987, strategic planning has played a critical role in defining where the organization wants to go and how it intends to get there. Each five-year plan we developed has been more ambitious than the last in terms of goals set, and more successful in terms of what we achieved.

The new plan leaves us poised for five more years of continued growth and improvement. While it did not take effect until April 1, 2003 – technically the start of the 2003–04 fiscal year – most of the work on the plan was done during fiscal 2002–03.

As you'll read on page 19, the plan provides a new mission statement and brand vision: *Discover the World.* It lays out in detail how we will continue to increase customer and employee satisfaction, build support for Ontario wines, maximize our contributions to the Ontario government and develop closer relationships with suppliers, while maintaining high standards of social responsibility.

We designed this plan to better equip our employees to take every customer on an engaging and enjoyable journey of discovery, demystifying the products we sell and helping them make more informed choices.

To be sure, there are significant challenges ahead. As President and COO Bob Peter notes on page 4, expenses in fiscal 2002–03 were slightly higher than planned and an ongoing shift in consumer tastes toward lower-margin products such as beer and coolers continued to drive our margin rate downwards. But with this plan as our roadmap, the next five years should prove as successful as the last five, as we continue to modernize, improve and transform ourselves on a daily basis to better serve customers and stakeholders.

The people of Ontario have become more sophisticated and mature in their knowledge of and attitude towards beverage alcohol, and expect us to be able to discuss and recommend products with confidence and expertise. The Government of Ontario expects us to deliver our services efficiently and cost-effectively and help it achieve its objectives in the areas of job creation, economic growth, support for domestic industries and opportunity for small business. Our social responsibility partners – and the public at large – expect us to promote moderation and the responsible use of alcohol, and to provide strong leadership and resources in the fight against impaired driving and underage drinking. Our suppliers and their agents expect us to collaborate with them on initiatives that give them fair opportunity to succeed in Ontario's competitive marketplace. Our employees expect us to provide a safe and productive workplace in which they can develop and fulfill their career aspirations.

With our new five-year plan, a seasoned senior management team, a strong Board and the ongoing support of government, I am confident our employees will deliver on these expectations in fiscal 2003–04 and beyond.

Andrew S. Brandt
Chair and Chief Executive Officer
Toronto, Ontario
August 2003

President's Message

We had an outstanding year in terms of sales and dividend but had to contend with rising expenses and declining margins

LCBO net sales rose by 6.1 per cent to an all-time high of $3.12 billion, the first time in our history that we broke the $3-billion mark. Given that net sales were under $2 billion as recently as 1995–96, this is a feat of which employees and stakeholders should be proud – especially since growth did not come at the expense of social responsibility.

Our dividend increased by $70 million to an eighth straight record of $975 million to help support government programs, services and capital projects. This increase was our largest ever in absolute dollars.

We made significant progress in our drive to reduce excess inventory and, after early growing pains that led to shortages of some products in some stores last summer, we improved product flow, lowered our average rolling inventory and freed up cash to upgrade more stores and increase our dividend.

There were also challenges to face, as we had to contend with rising expenses and declining margins.

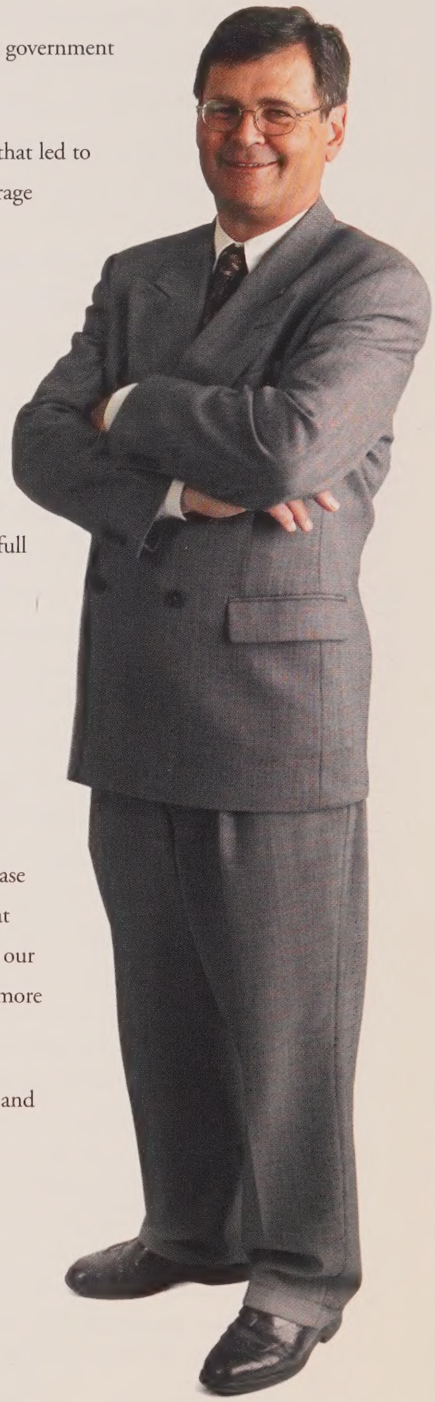
Expenses as a percentage of net sales came in at 16.7, higher than the planned figure of 16.5, for reasons explained on page 14. Because of this, the LCBO did not meet certain productivity targets for the year, despite increased sales.

Our margin rate declined again as the product mix continued to shift from higher-margin spirits to lower-margin beers and coolers. As a result, gross margins as a percentage of net sales dropped by a full percentage point in fiscal 2002–03, from 47.6 to 46.6 per cent.

In sum, we performed better than last year, but not as well as planned. Our targets were aggressive but setting the bar high has contributed to the ongoing improvement and success of the LCBO.

For 2003–04, we have again set aggressive sales and dividend targets. Controlling expenses remains an ongoing priority, with a target expense-to-sales ratio of 16.2 per cent for fiscal 2003–04. We will continue to introduce supply chain initiatives, working with suppliers to improve product flow and replenishment. Expanding and automating our London distribution facility will certainly help increase efficiency. To help address declining margin rates, we will review our markup structure to ensure that we are recovering all costs associated with moving our product to market. We are also working with our suppliers on innovative marketing plans to add excitement to the spirits category and will promote more premium products and gifts, which should improve the LCBO's overall margin rate.

We know where we have to continue to improve in fiscal 2003–04 and beyond, and have the plans and people in place to achieve our strategic and business objectives.



Bob Peter
President and Chief Operating Officer
Toronto, Ontario
August 2003

Corporate Governance

Our mission: to be a responsible, performance-driven, innovative and profitable retailer, engaging our customers in a discovery of the world of beverage alcohol through enthusiastic, courteous and knowledgeable service

Our customers are the people who buy our products and services. Our stakeholders include the people of Ontario, their elected officials, our employees, our trade partners and groups that share our concern for public safety. To serve their interests, we:

- deliver quality products and services at competitive prices
- distribute our products and services through a variety of retail formats and other sales channels, such as catalogues
- promote the responsible use of alcohol
- implement policies aimed at ensuring our workplaces are safe and free of harassment or discrimination
- control the importation, transportation, warehousing and sale of liquor outside of licensed premises, together with quality assurance and pricing, in a fair and impartial manner. (Regulatory responsibility for Ontario winery retail stores, Beer Stores, on-site brewery and distillery retail stores, and liquor delivery – previously held by the LCBO – was transferred to the Alcohol and Gaming Commission of Ontario effective July 3, 2001.)

To fulfill our responsibilities to the Government and people of Ontario, we:

- develop and implement programs and services aimed at deterring the sale of beverage alcohol to persons who cannot provide valid proof of age, who appear intoxicated, or who are believed to be buying for either of these parties
- maximize dividends to the Government of Ontario
- enhance the LCBO's value to the Government of Ontario
- manage the LCBO's business risks.

What is corporate governance?

Corporate governance means the processes and procedures a corporation uses to manage its business and affairs to enhance shareholder value. It includes ensuring the financial viability of the business and the corporation's positive relationship and dealings with stakeholders.

As an operational enterprise of the provincial government, we are not required to disclose our corporate governance practices, as are companies listed on the Toronto Stock Exchange. We believe, however, that effective corporate governance and accountability are essential to fulfilling our mandate and have included this section to increase understanding of how we are governed.

Members of LCBO's Board have responded to the need to establish forward-looking policies for corporate governance and to monitor these policies to ensure their effectiveness. The LCBO strives to meet the highest standards of both corporate governance and disclosure.

Mandate of the Board

The mandate of the Board is to supervise the business affairs of the LCBO. Among its most important responsibilities are:

- ensuring that the LCBO provides high quality service to the public
- developing and approving the strategic plan and monitoring management's success in meeting its business plans
- approving annual financial plans
- submitting an annual financial plan to the Minister of Consumer and Business Services
- ensuring that the organization remains financially sound
- assessing and managing business risks
- ensuring the organization has communications programs to inform stakeholders of significant business developments
- ensuring that the LCBO performs its regulatory role in a fair and impartial manner.

Appointment of Members to the Board

Members of the Board are appointed by the Lieutenant Governor, through orders-in-council, on the recommendation of the Premier and Minister of Consumer and Business Services. Members are appointed for a term of up to five years.

The LCBO provides new Members with a comprehensive orientation program, which includes information about its business operations, current strategies and issues, as well as visits to LCBO facilities. New Members also meet with senior management.

Responsibilities of Board Members

Each Board Member has individual responsibilities for corporate governance, including:

- acting honestly and in good faith in making decisions with a view to the best interests of the LCBO and all its stakeholders
- overseeing the management of the business and affairs of the LCBO
- avoiding conflicts of interest; Board Members may not enter into arrangements with the LCBO for personal gain
- having adequate knowledge of the LCBO's business, how it is organized and how it functions
- attending Board meetings and seeking professional advice where necessary
- exercising judgment independent of management
- providing guidance on policy development.

The strategic planning process

Since 1987, the LCBO has had a five-year strategic planning process. The process begins with an annual strategic planning conference whose purpose is to help define priorities and goals over the five-year period and shape our efforts over the shorter term. The Board approves the corporate strategies and reviews the objectives developed by each division to achieve them. Performance appraisals are tied to corporate and departmental business plans; every employee is assessed by how well he or she helps the LCBO achieve its objectives.

The strategic plan is supported by our five-year capital plan. For further information, please see page 16.

Audit and Governance Review Committee

The Audit and Governance Review Committee is composed of three Board Members elected annually by the Board. The Committee ensures the reliability and accuracy of the LCBO's financial statements, helps co-ordinate and improve its internal control functions, reviews and advises on possible changes to the LCBO's corporate governance policies and practices and ensures that the LCBO adheres to sound corporate governance principles. The Committee:

- monitors the Board's activities and operations
- reviews the LCBO's policy and procedures manuals to ensure that they describe adequate and commercially reasonable procedures and activities and set out appropriate control and management processes
- reviews the LCBO's strategic planning process and the appointment, training and monitoring of the performance of its senior management
- reviews the scope of the responsibilities of the LCBO's Chair and CEO and Board Members and the limits of senior management responsibility and makes recommendations to Board Members accordingly
- advises and counsels the LCBO General Audit Department
- in conjunction with the LCBO General Audit Department, reviews the LCBO's internal control system, internal compliance audits and the annual budget, and makes recommendations as required
- identifies the principal risks facing the business and reviews systems to manage these risks
- acts as a liaison among the LCBO Board, the LCBO's General Audit Department and the Provincial Auditor
- oversees the production of the Annual Report.

Ethics and business conduct

The Board is responsible for establishing and monitoring a system for corporate governance and for administering and enforcing a code of conduct for business ethics.

Following a review of the LCBO's corporate governance practices in March 1998, the Board approved a new policy for the conduct of the business of the corporation, including terms of reference and practices for the Board and for all committees of the Board. In April 1998, the Board approved a new Code of Business Conduct, with policies for conflict of interest; confidentiality; the outside activities of employees, officers and Board Members; gifts and entertainment; and human rights.

Health and safety

The Board approves an annual health and safety policy and ensures that regular meetings are held by joint bargaining unit and management health and safety committees. As part of its monitoring of the policy, the Board ensures it is kept informed of workplace health and safety issues.

Store Planning and Development Committee

This staff committee, which reports to the Board, reviews all real estate and leasing decisions and makes recommendations to the Board.

Listings Appeals Committee

The LCBO Listings Appeals Committee reviews appeals of denials of listing applications and decisions as to products that are delisted from sale through the LCBO.

Governance of the LCBO differs from private-sector corporations

In public companies, boards of directors usually perform a number of key responsibilities on behalf of shareholders to ensure an effective system of accountability. In the case of the LCBO, an operational enterprise of the Ontario Government, several of these functions are performed directly by government. This includes appointment of the Chair and CEO. In making major policy decisions, the Board often invites input from the provincial government and other stakeholders and takes into account government policy objectives.

Accountable to government and the public

The LCBO is held accountable by the Government and people of Ontario in a number of ways, including:

- its Annual Report, tabled in the Provincial Legislature and available for all Ontarians to review, either in print or online at *www.lcbo.com*
- annual audits of LCBO financial statements by the Provincial Auditor, as well as value-for-money audits of specific LCBO programs, including store planning
- public access to records under the *Freedom of Information and Protection of Privacy Act*
- publicly appointed Board Members
- statutory reporting requirements under the *Liquor Control Act* to the Minister of Consumer and Business Services and the Minister of Finance
- Memorandum of Understanding with the Minister of Consumer and Business Services setting out reporting requirements for the annual financial plan, capital plan and multi-year strategic plans
- compliance with Management Board's Agency Accountability Directives.

Beyond the Numbers 2002–03

Management Discussion and Analysis of Operations

Canadian securities regulations require public companies to include a discussion of operating results in their annual reports, along with annual financial statements. As a provincial government operational enterprise, LCBO is not subject to these regulations. However, we've included this discussion to increase understanding of our operations and ensure full disclosure of our results to the widest possible audience. This section of the LCBO Annual Report explains the financial results for the past year and provides background for evaluating its performance.

Senior Management Team 2002–03

1 Jackie Bonic
VP, Store Development & Real Estate

2 Alex Browning
Senior VP, Finance & Administration

3 Tamara Burns
VP, Merchandising

4 Nancy Cardinal
VP, Marketing Communications

5 Bob Downey
Senior VP, Sales & Marketing

6 Roy Ecker
Senior VP, Retail Operations

7 Mary Fitzpatrick
Senior VP, General Counsel & Corp. Sec.

8 Murray Kane
Senior VP, Human Resources

Continued page 11

HIGHLIGHTS

(value in $000s)

	2001–02	2002–03
Dividend to government	$905,000	$975,000
Per cent increase	6.5	7.7
Net sales and other income	$2,939,563	$3,119,240
Per cent increase	7.5	6.1
Operating expenses	$489,633	$525,959
Per cent increase	4.6	7.4
Net income	$920,913	$939,542
Per cent increase	5.1	2.0

Dividend increases for ninth straight year

We transferred a record $975-million dividend to government in 2002–03, a $70-million increase over last year, our largest ever year-over-year increase in absolute dollars. This is the ninth straight year we've increased our dividend and our eighth straight record year.

The following table gives a 10-year history of the LCBO dividend paid to the province of Ontario.

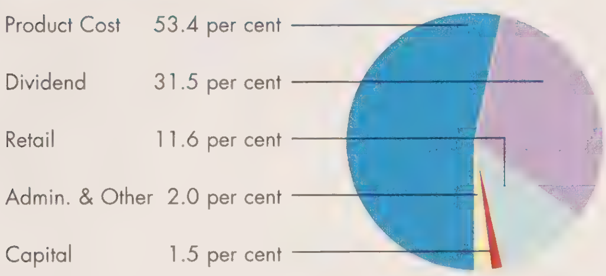
DIVIDEND	93/94	94/95	95/96	96/97	97/98	98/99	99/00	00/01	01/02	02/03
($000,000s)	$585	$630	$680	$730	$745	$780	$800	$850	$905	$975

The dividend has risen steadily in the past decade. Since 1993–94, the dividend has grown by 66.7 per cent or $390 million.

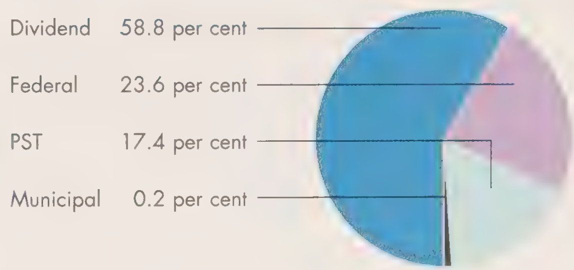
Billion-dollar payout for fifth straight year

The LCBO dividend does not include Provincial Sales Tax (PST), which amounted to $289 million in 2002–03. If you combine the dividend and the PST we collected, the LCBO broke the billion-dollar mark for the fifth straight year, giving our owners – the Government of Ontario – a total of $1.264 billion. This is 7.1 per cent more than last year. LCBO also remitted $97.5 million to the federal government in GST and $2.8 million in property taxes to municipal governments in 2002–03.

BREAKDOWN OF $1 IN NET SALES



LCBO PAYMENTS TO GOVERNMENT



LCBO sales growth remains strong

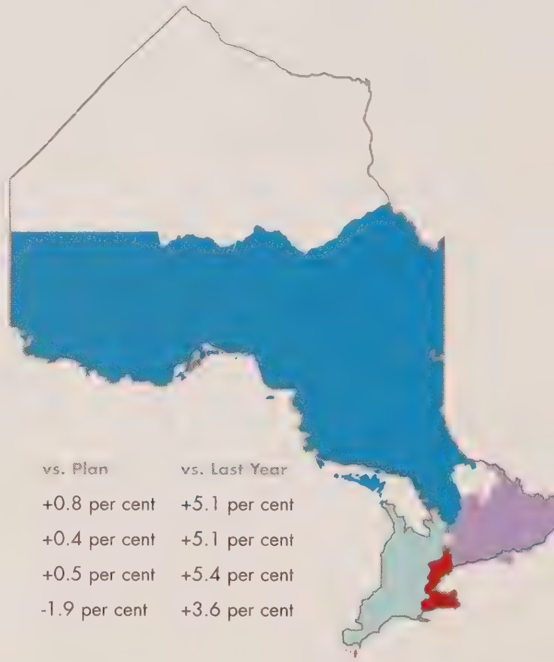
Despite a sagging U.S. economy, Ontario's strong economic performance underpinned LCBO's net sales growth of 6.1 per cent over fiscal 2001–02. LCBO sales rose by $177 million over last year, to $3.1 billion, surpassing the aggressive sales growth target of 5.1 per cent that was set at the end of last year.

The LCBO's sales have grown over the last five years by 35.6 per cent in volume and by 33.2 per cent in value. LCBO led all liquor jurisdictions in Canada in volume growth and only Quebec surpassed Ontario in terms of value growth. By comparison, the Société des alcools du Québec's sales volume grew by 31.4 per cent while dollar sales grew by 47.8 per cent.

Total retail sector sales in Canada grew 6.0 per cent between 2001–02 and 2002–03. According to Statistics Canada, Ontario underperformed the national average with retail sales growing by 5.5 per cent. LCBO was able to grow sales by 6.1 per cent, keeping pace with national retail sales growth and surpassing Ontario's average retail sales growth.

Growth exceeds plan in three of four regions

Three of the four LCBO retail regions bettered the budgeted growth rates for net sales in fiscal 2002–03, the exception being the Northern Region. The map on the right shows how each region fared compared both to plan and the year before.



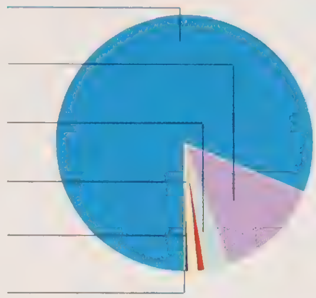
	vs. Plan	vs. Last Year
Central Region	+0.8 per cent	+5.1 per cent
Western Region	+0.4 per cent	+5.1 per cent
Eastern Region	+0.5 per cent	+5.4 per cent
Northern Region	-1.9 per cent	+3.6 per cent

Retail sales continue to be strong

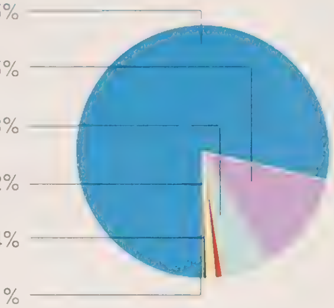
LCBO retail sales, which we define as sales to home consumers, grew by 5.0 per cent over last year and accounted for 78.5 per cent of the LCBO's total net sales, amounting to $2.43 billion. Last year, they grew by 7.7 per cent over the year before and, at $2.32 billion, accounted for 79.3 per cent of total net sales.

Sales to The Beer Store (TBS) increased by 22.0 per cent, due to continuing growth in the sale of imported beer. These sales now account for 6.4 per cent of total LCBO net sales, up from 5.5 per cent last year.

BREAKDOWN OF LCBO SALES 1998–99



BREAKDOWN OF LCBO SALES 2002–03



Licensee sales accounted for 12.5 per cent of total net sales in fiscal 2002–03, down from 12.8 per cent, while sales to duty-free operators accounted for 1.2 per cent, which was the same as last year. Sales to agency stores increased from 1.0 per cent of total sales to 1.4 per cent, due to a 50-store expansion in the network. *(For more information on the agency store program, see page 36.)*

Weakness in the tourism industry, resulting mainly from an economic downturn and political uncertainty in the United States, dampened sales through the licensee and duty-free channels. Sales to licensees were below plan by 6.1 per cent while duty-free sales fell short of plan by 0.6 per cent. Sales through these channels did, however, improve from last year when the events of September 11, 2001 led to declining sales. Compared to actual sales in 2001–02, sales to licensees were up 3.5 per cent and duty-free sales rose 6.7 per cent.

Since legislative changes were implemented in 1999, Ontario wineries' direct delivery sales of VQA products to licensees have grown quickly. In fiscal 2002–03, VQA direct delivery by Ontario wineries increased by 30.9 per cent, while LCBO domestic wine sales

Hugh Kelly
Senior VP, Information Technology

Bill Kennedy
Executive Director, Corporate Communications

11 Gerry Ker
Executive Director, Corporate Policy

Ian Martin
Senior VP, Logistics

Barry O'Brien
Director, Corporate Affairs

Dr. George Soleas
VP, Quality Assurance

15 Shelley Sutton
Director, Strategic Planning

16 Tom Wilson
VP, VINTAGES

to licensees fell by 10.7 per cent. In 2002–03, direct delivery of VQA products represented 13.9 per cent of the total volume of the licensee market for wine, compared to 12.0 per cent in 2001–02.

Combined, these wholesale sales represented 21.5 per cent of total LCBO net sales, up from 19.0 per cent five years ago.

LCBO in the shared marketplace

The LCBO operates in a shared marketplace along with other retailers of beverage alcohol, including The Beer Store (TBS), Ontario winery retail stores (WRS), on-site brewery stores, agency stores, duty-free operators and on-site distillery stores. As at March 31, 2003, there were 1,628 outlets selling alcohol in Ontario.

In fiscal 2002–03, the LCBO opened 50 new agency stores in smaller communities throughout Ontario. The agency store program has greatly improved beverage alcohol service for residents and visitors in rural areas and smaller communities, while maintaining the LCBO's social responsibility standards. It also helps stimulate local retail traffic and revenue, increases employment for local residents and broadens the host community's business base while improving LCBO's revenues. The agency store network will be further expanded in the coming year. *(For more information on the program and its expansion, please see page 36.)*

Here is what the market looked like at March 31, 2003 (percentages have been rounded):

- 597 LCBO stores (36.7 per cent of all outlets)*
- 436 Beer Stores (26.8 per cent of all outlets)
- 384 Ontario winery retail stores (23.6 per cent of all outlets)
- 155 agency stores (9.5 per cent of all outlets)
- 39 on-site brewery stores (2.4 per cent of all outlets)
- 11 land border-point duty-free stores (0.7 per cent of all outlets)
- 3 on-site distillery stores (0.2 per cent of all outlets)
- 3 airport duty-free stores (0.2 per cent of all outlets).

* If you combine the LCBO's 597 stores and Ontario's 155 agency stores, the market share is approximately 46 per cent.

Changes in market share[1]

The total Ontario beverage alcohol marketplace amounted to almost $8.0 billion in gross sales in 2002–03. The LCBO's market share by value increased from 44.6 per cent in 2001–02 to 45.5 per cent in 2002–03. Winery retail stores sales grew by 6.1 per cent and increased market share from 2.2 per cent in 2001–02 to 2.3 per cent in 2002–03. The Beer Store's market share also increased in 2002–03, rising from 32.3 per cent to 32.4 per cent.

Other legal sales

Other legal sales, such as cross-border and brew-pubs, declined by 5.9 per cent from fiscal 2001–02 and the market share for these channels declined from 14.9 per cent in 2001–02 to 13.7 per cent. This is due mainly to a decline in the number of brew-on-premise establishments which, after several years of strong growth, declined in market share from 11.0 per cent in 2001–02 to 9.9 per cent in 2002–03. The number of licensed U-brews and U-vints in the province declined by 5.7 per cent in 2002–03.

[1] Revisions to 2001–02 numbers have been made as new data became available.

Illegal competition

The estimated size of the illegal market in Ontario has been relatively stable in the past few years. The market share in this channel increased slightly from 6.0 per cent in 2001–02 to 6.1 per cent in 2002–03. This illicit channel is estimated to redirect revenues of $456 million, up from $432 million last year.

The Income Statement

Net income up by [illegible]

Net income for fiscal 2002–03 was $940 million, almost $19 million higher than last year, representing a 2.0-per-cent increase.

The net-income-to-net-sales ratio was 30.3 per cent, just missing the 2002–03 target of 31.1 per cent and lower than last year's ratio of 31.5 per cent.

Our expense-to-net-sales ratio missed expectations. It was originally forecast at 16.5 per cent and came in at 16.7 per cent in fiscal 2002–03. More detail is provided in the section on productivity ratios.

Our net sales growth of 6.1 per cent was excellent, particularly in light of the economic slowdown this year. It surpassed the target of 5.1 per cent set at the end of last year.

[illegible]

Gross margin grew a healthy $52.7 million to $1.44 billion in fiscal 2002–03. This missed the planned target by 0.4 per cent but compared to last year, was higher by 3.8 per cent.

Gross margin as a percentage of net sales for 2002–03 was 46.6 per cent, below last year's 47.6 per cent, and slightly below the target of 47.2 per cent. The decline in the gross-margin-to-net-sales ratio reflects the continuing shift in the sales product mix from spirits towards beer, wine and coolers.

For every dollar of net sales, our gross margin return on spirits is $0.56. On wine, it is $0.49 and on beer $0.28. Beer and wine now represent 53 per cent of total net sales, up from 52 per cent last year and 48 per cent five years ago. The increasing strength of beer and wine in the product mix means an ever-greater proportion of our sales dollars come from the sale of lower-margin product lines.

The 10.3-per-cent growth in the wholesale market also added to the lower gross-margin ratio, because of the discounts provided on these sales.

Productivity ratio[illegible]

To track expenses and see where improvements are needed, LCBO sets targets for many productivity ratios each year. For example, the store expenses-to-sales ratio shows what percentage of net sales is needed to pay retail expenses such as salaries, rent and other expenses. A declining salary expenses-to-sales ratio means that staff are becoming more productive.

Retail productivity

The LCBO has consistently improved its retail productivity ratios year over year. In fiscal 2002–03, we once again performed better than last year but were unable to meet the aggressive targets we set at the end of fiscal 2001–02.

LCBO's commitment to improving the store network and enhancing customer service led to significantly higher sales over last year. Unfortunately our expenses exceeded our targets and led to productivity levels slightly better than last year, but below plan.

Store salaries to sales: Store salaries were slightly over budget by 0.3 per cent; we missed the target of 7.0 per cent, ending at 7.3 per cent.

Store expenses as a percentage of sales: Higher controllable labour costs led to slightly higher store expenses and resulted in a ratio of 10.4 per cent, missing the target of 10.1 per cent.

Store salary per unit sold: Higher salary costs resulted in the ratio coming in $0.03 over target at $0.78.

Store expenses per unit sold: Came in at $1.11, above the target of $1.08.

Unit sales per hour: Came in at 31.3, missing the target of 34.0. This was better than last year, but still below expectations.

Sales per customer: At $28.51, consumers were spending more than last year's result of $28.10 but below the target of $28.78.

Sales per square foot: Up from last year's $1,752 to $1,755, but missing the target of $1,791.

RETAIL – FINANCIAL AND OPERATING HIGHLIGHTS

	98-99	99-00	00-01	01-02	02-03
Store salaries to sales	7.8%	7.6%	7.9%	7.4%	7.3%
Store expenses as percentage of sales	10.6%	10.5%	11.0%	10.4%	10.4%
Store salaries per unit sold	$0.85	$0.84	$0.87	$0.80	$0.78
Store expenses per unit sold	$1.16	$1.17	$1.22	$1.13	$1.11
Unit sales per hour	25.8	25.7	25.5	28.6	31.3
Sales per customer	$26.19	$27.19	$27.86	$28.10	$28.51
Sales per square foot	$1,546	$1,674	$1,693	$1,752	$1,755

Note: Unit sales per hour refers to the average number of units sold in LCBO stores per operating hour.

Logistics productivity

The logistics side of the business did not achieve all its productivity goals this year, meeting three of seven targets. Higher than expected expenses, such as compensation, rent, utilities, breakage and outbound freight, led to this result.

Warehouse salary cost per case: This year's ratio came in at $0.83, surpassing the target of $0.84.

Warehouse cost per case: This ratio missed the target of $1.08, coming in at $1.10 per case.

Logistics cases per hour: Beat the target of 61, coming in at 66 cases per hour.

Logistics cost per case handled: Higher by $0.05 per case compared to last year and missed the target of $0.62 by a small margin, coming in at $0.64 per case handled.

Freight expense per case: Increased significantly compared to last year's value of $1.11 and missed the target of $1.20, coming in at $1.26 per case.

Inbound freight as a percentage of sales: Fuel costs remained high this year which led to this ratio coming in above the target of 1.9 per cent, as well as last year's 1.9 per cent, at 2.2 per cent.

Outbound freight as a percentage of sales: Met its target by coming in at 0.7 per cent.

LOGISTICS – FINANCIAL AND OPERATING HIGHLIGHTS

	98-99	99-00	00-01	01-02	02-03
Warehouse salary cost per case	$0.75	$0.75	$0.76	$0.77	$0.83
Warehouse cost per case	$0.95	$0.98	$0.95	$1.00	$1.10
Logistics cases per hour	62	62	64	64	66
Logistics cost per case handled	$0.58	$0.59	$0.57	$0.59	$0.64
Freight expense per case	$1.07	$1.13	$1.16	$1.11	$1.26
Inbound freight as percentage of sales	1.9%	2.0%	2.0%	1.9%	2.2%
Outbound freight as percentage of sales	0.5%	0.6 %	0.6%	0.6%	0.7%

Note: For certain logistics ratios, the prior years have been restated due to the reclassification of one of our facilities. For logistics cases per hour, the prior years have been restated, as warehouse hours now reflect all hours worked.

Operating expenses on track

The administrative expense ratio remained unchanged from 2001–02, at 1.3 per cent. This matched the target for the fiscal year.

Operating expenses as a percentage of net sales remained relatively stable (16.6 per cent in 2001-02; 16.7 per cent in 2002–03). This missed the target of 16.5 per cent[2].

2 This ratio is as per our internal management reporting and thus will not match the ratio in the Financial table on page 44 of the "Financial Overview" section.

Balance Sheet

Liabilities up

Liabilities, consisting of accounts payable and accrued benefit obligations, rose from $248.1 million in 2001–02 to $299.5 million in 2002–03.

Year-end inventory and turns both up

Year-end inventory was up from $226.3 million in 2001–02 to $247.5 million in 2002–03. This is due in large part to the impact of a much higher than anticipated inventory in transit from suppliers, which is only recognized at year end. Total inventory turns rose from 6.0 in 2001–02 to 7.5 in 2002–03, but missed the target of 8.8; closer control over inventory contributed to this improvement over last year.[3] Higher inventory turns result in more cash flow, which frees up funds to improve more stores and increase our dividend.

Changes in our financial position

Less cash on hand

LCBO's cash position decreased from $80.1 million in 2001–02 to $46.4 million at the end of 2002–03.

CAPITAL EXPENDITURES (values in $000s, numbers rounded)

	98-99	99-00	00-01	01-02	02-03
Retail	17,730	23,112	39,984	31,458	46,570
Information Technology	17,834	24,895	7,375	14,259	12,758
Logistics	1,658	1,760	2,066	3,493	11,848
Marketing Programs	2,558	2,434	1,231	1,730	1,565
Other Administrative Divisions	1,179	1,463	2,409	1,347	1,265
Systems Improvements	N/A	808	2,624	3,448	1,056
Total Capital Expenditures	40,959	54,472	55,689	55,735	75,062

As part of our five-year strategic plan to make LCBO the *Source for Entertaining Ideas*, most of the capital budget was again allocated to upgrading more retail stores to current corporate standards. This increased capital investment over the past five years was necessary because many of LCBO's stores did not meet these standards. Research shows that new and upgraded stores – better located and more appealing places to shop – increase both sales and customer satisfaction.

Fiscal 2002–03 saw a significant increase in logistics investment. This reflects the GTA Services Centre warehouse move from Toronto to Mississauga and the automation of the London warehouse. Information technology investment continues to be significant due to the Integrated Store Environment (ISE) project (which includes a new point-of-sale [POS] system and Sales Audit system), a new

3 Inventory turn numbers have been restated due to an internal reporting change.

Human Resources/Payroll system and an upgrade in our Oracle application. The investment in our information technology infrastructure reflects our commitment to improving operational efficiencies.

Looking Ahead

In fiscal 2003–04 the successful identification and management of key issues in retail and logistics will result in a forecasted net sales increase of 6.9 per cent or $214 million to $3.3 billion.

As we enter the first year of a new five-year plan in 2003–04, we continue to look for and act upon opportunities for improvement, focusing on customer service. The LCBO will support frontline employees by providing training; by providing innovative marketing that captures and expresses the spirit of our new brand vision, *Discover the World*, which you can read more about on page 19; by continuing to improve store formats, locations and product selection; and by continuing to decrease unnecessary product handling through door-to-floor and other supply chain improvements, so employees can spend more time serving customers. Of equal importance will be warehouse and systems upgrades in Toronto, London and at our main Durham facility, as well as the expansion of the London warehouse so it can serve more stores in the west.

Divisional expenses are expected to rise by 3.8 per cent. This increase is being driven by a number of factors, including higher rent and realty and business taxes; training costs to improve customer service; higher salaries and benefits to handle planned sales increases and to attract and retain qualified employees; and increased spending on advertising and merchandising initiatives.

Volume sales are expected to increase by 6.3 per cent next year while the gross margin percentage is expected to continue its decline under the combined market pressures of stronger sales of lower-margin products and fixed markup rates, coming in at 45.7 per cent. This will drive net income down to 30.0 per cent of net sales as net income increases by 5.7 per cent from $940 million to $993 million[4].

Our product costs as a percentage of net sales are projected to rise from 53.4 per cent in 2002–03 to 54.3 per cent in 2003–04.

Our expense-to-net-sales ratio was originally forecast at 16.5 per cent, but came in slightly higher at 16.7 per cent in fiscal 2002–03. This ratio is forecast to come in at 16.2 per cent in 2003–04, as we aggressively control costs and implement additional efficiencies.

The LCBO is expected to decrease its capital expenditures in 2003–04 by $22.4 million, from $75.1 million to $52.7 million. Most of the decrease in capital project expenditure will be in Retail and IT. However, we will continue to open, expand and relocate stores where populations grow. And in other markets, the LCBO will do aesthetic upgrades. Over the next five years we plan to upgrade about 200 stores in total, spreading our investment over markets of all sizes, both urban and rural *(for more information, please see page 34)*. In 2003–04, we are also investing in the expansion of our London warehouse, which will nearly double in size and more than double its storage and throughput capacity.

Our dividend to the Government of Ontario should increase for the tenth consecutive year to more than $1 billion, an increase of at least $25 million or 2.6 per cent. Having achieved a $975-million dividend in fiscal 2002–03, we transferred $300 million more than originally forecast over the five-year plan from 1998–99 to 2002–03.

4 For fiscal 2003–04, there has been a change in the way Ontario beer fees are collected. Ontario beer fees were originally collected by the Alcohol and Gaming Commission of Ontario (AGCO), but this responsibility has been transferred to the LCBO. This change will increase our net income and decrease the cost of Ontario beer sold. The LCBO plan numbers do not take into account the $38 million we expect to gain from this change.

The LCBO's new brand vision, *Discover the World*, is based on research that shows customers want LCBO employees to demystify the products we sell and take some of the perceived risk out of their purchases.

Discover the World

Our new five-year strategic plan, which took effect April 1, 2003, will launch a new brand vision for the LCBO

By any definition, the LCBO's five-year plan that guided operations from 1998 to 2003 was a great success:

- We set new records for revenues and dividends every year.
- We transferred $4.3 billion to the government, $300 million more than forecast, to support social programs, services and capital projects.
- We continued to improve customer service, store environments, marketing programs, staff training, supply chain processes, productivity and operational efficiency.
- We consistently outperformed the Ontario retail market and other beverage alcohol markets.
- We added to our standing as a leader in social responsibility.

We also began building and integrating a brand vision. LCBO stores would be more than a place to buy beverage alcohol – they would be Ontario's *Source for Entertaining Ideas*, where customers would seek products and advice to help them entertain easily, adventurously and responsibly.

From 1998 to 2003, this vision took root in many LCBO stores, where we brought to life themes and concepts articulated in our popular consumer magazine, *FOOD & DRINK*. It became a focal point for staff and helped redefine alcohol as part of a balanced lifestyle.

But as we raised awareness of and interest in our products and services, we also raised expectations that, because of capital and space constraints, could not be met to our satisfaction in every store, as a successful brand promise must do. So when we began developing a new five-year plan, our first step was to conduct extensive customer research, asking people what LCBO programs, products and services appealed to them, and what could make their shopping more informative and enjoyable.

We learned that customers want LCBO employees to demystify the products we sell and take some of the perceived risk out of their purchases. They want LCBO employees to engage and guide them on a journey of learning and discovery.

Based on these findings, the plan was built around a new brand vision: *Discover the World.*

This vision can be extended to every store in our network, because we offer a wide selection of products from near and far, and most staff already have the knowledge and ability to serve as "tour guides".

The LCBO will support frontline employees' efforts by:

- providing appropriate training
- providing more tastings, classes, notes and other materials to help customers expand their product knowledge
- showcasing products from Ontario and more than 60 countries worldwide
- continuing to improve store formats and locations
- reducing unnecessary product handling so employees can spend more time engaging customers.

We believe this plan – which the public will begin to see in stores in the fall of 2003 – will achieve the same success as our previous strategic plan, while meeting heightened expectations in all markets.

While there is much that is new, we consider it evolutionary, not revolutionary – the next logical step in our ongoing transformation.

The plan sets out these six objectives for the years 2003–08:

1. to increase customer satisfaction
2. to promote the responsible use of beverage alcohol
3. to maximize returns to the people of Ontario by generating a total of $5.14 billion in dividends over the next five years
4. to develop and improve collaborative relationships with suppliers
5. to promote the growth of Ontario wine sales
6. to increase employee satisfaction.

Because every employee has a role to play in the plan's success, an extensive rollout began in February 2003.

"Frontline employees are the ones who will bring this vision to life in stores, who will engage customers in this voyage of discovery," notes President and COO Bob Peter. "Without their active and enthusiastic participation, all we have are words on a page."

Our mission: to be a **responsible,** performance-driven, **innovative** and profitable retailer, **engaging** our customers in a discovery of the world of beverage alcohol through enthusiastic, courteous and **knowledgeable** service.

Echo Boomers, the children of Baby Boomers, spend more per annum in our stores than any other demographic group. Some 750,000 are expected to come of legal drinking age over the course of our 2003–08 five-year strategic plan.

Product Trends 2002–03

Spirits

Up 1.4 % value
Up 0.7 % volume

Wines

Up 6.4% value
Up 3.6% volume

VQA (Ontario)

Up 14.2 % valu
Up 12.2 % volum

Beer

Up 12.1 % value
Up 8.7 % volume

Coolers

Up 19.2 % value
Up 17.9 % volume

VINTAGES

Up 6.4 % value
Up 10.3 % volume

Category totals provided here do not include sales through VINTAGES and the LCBO Private Stock Program, and therefore may not match totals found in the Financial Overview section of this Annual Report.

Wines

Mission: to provide our customers with an exceptional selection of quality wines at affordable prices; to educate customers so they can serve our products with confidence; to help customers entertain in the context of a healthy everyday lifestyle; and to be one of the first international markets where innovative new products are launched.

Customer enthusiasm for red wines, and a willingness to move up to premium price bands, led the Wines Category to another strong year. Dollar sales grew by 6.4 per cent to $819 million, 3.0 per cent above plan. Litre sales grew by 3.6 per cent to 83 million litres, 0.6 per cent above plan.

Director Kate Mallett-Thomas cites three main factors:

- tremendous growth in red wine sales
- increased sales in premium price bands
- strong sales of wines from top producers such as Australia, Italy and Canada (primarily Ontario), which together enjoyed an 11-per-cent dollar increase.

Red wine sales grew by 11.0 per cent in dollars and 8.0 per cent in litres. By contrast, white wines grew by 2.7 per cent in dollars and 0.8 per cent in litres. In fact, fiscal 2002–03 marked the first time ever that the LCBO sold more red wine by volume than white: 48 per cent of table wines by volume were red; 47 per cent were white.

Premium wines continued to grow faster than lower-priced brands. Wines priced between $10 and $15 rose 16.2 per cent in litres over last year; wines between $15 and $20 rose 6.1 per cent; wines between $20 and $25 rose 9.7 per cent; and wines between $25 and $35 rose 7.5 per cent. Sales of wines under $10, which make up 85 per cent of the category's portfolio in litres, grew by a healthy 1.9 per cent, showing that customers are finding products to suit every taste and budget.

In terms of country/region of origin, Australia continued to set the pace, with sales rising by 32 per cent, topping the 29-per-cent growth averaged over the previous five years; market share grew to 14 per cent. The success of Australian wines, which boosted it past the U.S. into fourth place in terms of market share, can be attributed to consumer preferences for consumer-friendly red wines that offer good value for the money; strong strategic planning and collaboration within the Australian industry; and customer loyalty to top brand "families" such as Wolf Blass, Lindemans and Rosemount. Australian white wines also did well in fiscal 2002–03; their Chardonnays, for example, which represent almost 70 per cent of Australian white wines, grew by 31.1 per cent.

The largest share of the Wines Category portfolio, which does not include VINTAGES products, is held by Canada at 25 per cent. In fiscal 2002–03, sales of Canadian wines (most from Ontario) grew by 3.9 per cent in value. *(For more information on Ontario wines, and the role LCBO plays in promoting them, please see page 32.)*

The next largest producer, France, saw a 0.2-per-cent decline in sales growth, due largely to the poor performance of its blended table wines, and now holds a 19-per-cent market share.

Sales of wines from Italy continued their steady growth of recent years, increasing by 9.7 per cent, and now hold a 17-per-cent market share. Food-friendly varietals, including Pinot Grigio and Valpolicella, are key drivers of growth.

In fifth place behind Australia was the U.S. Its wine sales declined by 0.8 per cent and it now commands 9.0 per cent of the market. Over recent years, the unfavourable exchange rate between the Canadian and American dollars pushed up the price of many California wines, prompting many customers to seek better value offerings from Australia and Chile.

Other top producers were:

- Chile (5.0-per-cent growth/5.0-per-cent market share)
- Spain (6.7-per-cent growth/4.5-per-cent market share)
- Germany (0.7-per-cent growth/2.4-per-cent market share)
- Portugal (1.8-per-cent decline/1.9-per-cent market share)
- Others, including South Africa, New Zealand, Argentina, Greece, Hungary and Bulgaria: combined 3.0-per-cent growth rate/combined 6.8-per-cent market share.

Other Trends

- Imported fortified wines declined by 3.9 per cent in litres and 0.4 per cent in dollars.
- Imported sparkling wines grew by 1.9 per cent in litres and 6.6 per cent in dollars.
- Domestic sparkling and fortified wines declined by 7.6 per cent in litres and 4.1 per cent in dollars.
- Flavoured wine drinks (made with wine, carbonated water and fruit flavouring) rose 18.4 per cent to nearly $15 million.

Looking Ahead

Plans for 2003–04 include:

- new marketing strategies and programs, grounded in research, designed to encourage customers to browse and try new products
- continued partnership with the Ontario wine industry to promote its products in our stores
- training initiatives that help demystify wine and take the perceived risk out of shopping for new products
- improved selection of gift, niche and ethnic products
- new product forecasting and replenishment procedures
- promotions and other initiatives designed to boost sales of wines from the top-producing countries and regions.

Spirits

Mission: to showcase the mixability, diversity and vitality of spirits, and make spirits the must-serve drink.

In July 2002, the LCBO invited representatives of every major distiller in Ontario to discuss issues of mutual interest and explore new opportunities to market and sell spirits.

According to Director Shari Mogk-Edwards, high atop their list of concerns were declining sales of Canadian whisky, which account for some 10 per cent of LCBO revenues. Sales of Canadian whisky decreased by 1.2 per cent in fiscal 2002–03, and the segment has lost 2.8 per cent in market share over the past five years, during which time no other segment lost more than 0.6 per cent.

Other topics included:

- how to make spirits displays more appealing to customers, especially “Echo Boomers” and women
- how to improve marketing and promotional initiatives
- how to leverage research to better understand customers’ shopping patterns and purchase decisions
- how additional training of LCBO retail staff could further enhance their ability to inform customers about spirits
- how to maximize inventory flow to ensure stores have the products customers want, when they want them.

Nine working groups have since been developing action plans and initiatives, some of which are being tested in LCBO stores. One result was a month-long spirits promotion called *Shake It Up*, designed to help consumers learn more about appealing shaker cocktails.

Also in development are a five-year strategic plan to help the LCBO and suppliers maximize growth potential; and a joint performance scorecard to assess their progress against the plan’s goals and objectives.

Market share declining

As consumer tastes shift toward beer and coolers, the market share of spirits declines accordingly. In 1992-93, for example, spirits accounted for 58.5 per cent of LCBO net sales; in 2002–03, just 42 per cent. This is a cause of concern, as the margin per unit of spirits sold is considerably higher than that of beer, coolers or wine.

This is not to suggest the category is in decline; its sales have increased for seven straight years. But its rate of growth in fiscal 2002–03 (1.4 per cent) did not match those of beer (12.1 per cent), wine (6.4 per cent) or coolers (19.2 per cent).

Segments that did well in fiscal 2002–03 include vodka, especially flavoured products; Irish and American whiskey; brandy and Cognac; liqueurs; tequila; and gift packs.

The highest rates of growth were for premium and deluxe products in higher price bands. These grew by 6.3 per cent ($35-$49.95), 9.5 per cent ($50-$74.95), 8.5 per cent ($75-$99.95) and 8.8 per cent ($100 and up). By contrast, standard products priced between $20.00 and $34.95 declined by 4.5 per cent.

Imported spirits fared better than domestic products, growing in volume by 2.4 per cent and value by 3.1 per cent (excluding coolers). Domestic spirits declined by 1.0 per cent in volume and 0.3 per cent in value (also excluding coolers).

Looking Ahead

The Spirits Category's goals for 2003–04 are:

- to continue to work with suppliers to develop initiatives that maximize growth
- to continue to market premium and deluxe products with higher profit margins, while providing a wide range of standard products
- to educate consumers about spirits and encourage them to try new products
- to bring more new products to market (45 were introduced in fiscal 2002–03)
- to increase spirits' holiday giftpack sales by 10 per cent over last year, to $15 million, and grow year-round gifting opportunities
- to improve inventory turns for domestic spirits by 12 per cent; for imported products by 11 per cent; and duty-free products by 6.5 per cent
- to grow duty-free sales, which account for about 3 per cent of the category's overall sales, from $35 million to $38 million
- to develop more incremental sales, since 66 per cent of consumers make unplanned purchases.

Beers & Special Markets

Mission: to be a performance-driven, profitable business unit, fulfilling the diverse needs of our customers through easy-to-shop layouts, exciting promotions, knowledgeable staff, world-renowned premium beers and Party Zone products.

In the past five years, sales in Beers & Special Markets have precisely doubled: from $392 million in 1997–98 to $784 million in 2002–03. This year, the category's 12.4 per cent growth rate more than doubled the corporate rate of 6.1 per cent.

According to Director Randi Landy, the category has succeeded by continuously bringing intriguing new premium beers, both domestic and international, to the Ontario market; and by capitalizing on consumer interest in spirit coolers. (Beers and spirit coolers accounted for 93 per cent of category sales in fiscal 2002–03, with the rest coming from wine and beer coolers, cocktails-to-go, saké, ciders, kosher products and accessories.)

Other factors that contributed to sales growth in fiscal 2002–03 include:

- fine weather throughout the spring and summer of 2002
- new beer and "Party Zones" in selected stores that group beers, coolers and other products that appeal to outgoing and active customers
- increased refrigeration and space for beer and Party Zone products
- training materials, including an award-winning video, to help retail staff better serve their customers
- an improved selection of holiday gift items, sales of which rose 29 per cent to $2.1 million.

Here is a look at how segments within the category fared in fiscal 2002–03:

Imported non-U.S. beer: the largest contributor to sales, with 43.2 per cent of the beer category, and the fastest growing segment, with sales up 19.0 per cent over the year before. Just over 150 non-U.S. beers from 37 countries were offered last year, led by such dominant brands as Corona and Heineken. Beers from Belgium, Mexico and Denmark enjoyed the greatest growth in fiscal 2002–03.

Ontario beers: grew by 6.6 per cent in fiscal 2002–03, with a 40.2-per-cent share of the beer category. This segment includes popular brands from major producers such as Labatt and Molson, as well as craft beers from Ontario's many micro-breweries.

U.S. beers: grew by 4.3 per cent, despite the fact that the popular Busch brand began being produced in Ontario and is therefore considered domestic.

Out-of-province beer: grew by 17.0 per cent this fiscal year, largely driven by Moosehead and Alexander Keith's IPA.

In general, most best-selling beers, whether imported or domestic, were lagers. Even the ales that are doing well, like Keith's and Sleeman's, are made in a lighter, more easy-drinking style.

Spirit coolers: grew 18.6 per cent over the year before. This segment has enjoyed enviable growth since 1997–98, led by citrus-flavoured vodka-based drinks like Mike's Hard Lemonade and, more recently, Smirnoff Ice. Suppliers continue to innovate, and in fiscal 2002–03 introduced lighter, less sweet brands such as Pur Source from Labatt.

Wine and beer coolers: wine cooler sales declined by 19.8 per cent over the past year, due to customer preferences for spirit coolers. Sales of beer coolers through LCBO stores declined by 63.3 per cent.

Cocktails to go: sales of pre-mixed cocktails increased by 8.3 per cent, and now account for 3.9 per cent of category sales.

Saké: sales grew by 17.2 per cent to $2.4 million, due in part to the increasing popularity of Asian foods.

Ciders: continued to decline, down 6.1 per cent from the year before.

Kosher: showed a decline of 18.9 per cent mainly because Passover, one of the largest buying occasions, fell outside the LCBO's fiscal year.

Accessories: declined by 7.3 per cent as the LCBO opted to no longer sell certain lifestyle items, and now offers only gift packaging and beverage-alcohol related accessories. Accessories now account for less than one per cent of category sales.

Looking Ahead

Beers & Special Markets plans to grow its business by another 12.2 per cent in fiscal 2003–04, to $880 million. Margin dollars are expected to improve by 9.4 per cent to $273 million.

It will do this by:

- engaging more customers aged 20-29, the highest-spending age group among our customers
- continuing to improve its selection of premium domestic and imported beers
- working with key vendors to further improve the flow of goods and reduce inventory costs
- continuing to train employees so they can help more customers discover exciting new products to try
- providing more informative product notes and displays
- testing new merchandising concepts and fixtures – like walk-in cold rooms in non-combination stores
- cross-merchandising beer with complementary products.

VINTAGES

Mission: to be the international leader in the buying, marketing and retailing of fine wines and premium spirits.

VINTAGES, the LCBO's fine wine and premium spirits division, searches the world for products that are unique and of exceptional value, providing customers with an ever-changing assortment of the world's best. This year VINTAGES brought more than 3,100 products to market through retail releases, direct marketing programs and special events.

VINTAGES' sales grew by 6.4 per cent in fiscal 2002–03. VP Tom Wilson attributes this lower than usual sales growth to discounting that occurred in 2002 to reduce excess inventory. Over the next four years, Wilson projects VINTAGES' sales to grow by 15 per cent a year.

While VINTAGES' portfolio includes red, white and rosé table wines, Icewines, sparkling and fortified wines, spirits and liqueurs, it is primarily a red wine business.

Of its $155 million in sales last year, $97 million came from red wine, almost 90 per cent of which came from four countries (France, Italy, Australia and the U.S.).

Here's what other segments contributed:

- **White wine,** mainly from France, Canada, the U.S., Italy and New Zealand, accounted for $37 million
- **Spirits and liqueurs,** mostly single malt and blended Scotch whiskies, accounted for $7 million
- **Sparkling wine,** mostly French Champagne, accounted for $5 million
- **Fortified & Specialty Wine,** mostly Port, accounted for $4 million
- **Rosé,** mainly from France and Canada, accounted for $800,000.

Many VINTAGES products are rare finds, often made in limited quantities. While VINTAGES obtains the largest possible allocations of such products, it faces challenges in satisfying all customers who are interested in purchasing them.

In May 2002, VINTAGES began releasing products twice a month, rather than once, to improve product flow and on-shelf presentation; and to create incremental sales opportunities by encouraging customers to visit stores more often.

Monthly releases feature up to 175 new products and often include "thematic releases" highlighting a particular region, sub-region, producer or varietal. These account for 85 per cent of VINTAGES' sales.

VINTAGES also makes products available through the following programs:

***Classics Catalogue*:** a direct marketing program that offers more than 1,000 new and unique products annually. Published three times a year, the catalogue now accounts for $15 million a year, roughly 10 per cent of VINTAGES' sales.

Futures/Pre-arrivals: futures give customers the opportunity to buy fine wines before they are bottled, usually at a significant discount. Pre-arrivals allow customers to buy products before they are widely commercialized.

Cellar Direct: encourages customers to collect and cellar wine. Each month a new product is made available in lots of three. Two products a month will be offered beginning in September 2003.

VINTAGES Essentials: a core group of products that are continuously available in stores. These proven favourites accounted for $30 million in sales in fiscal 2002–03, and are growing by 30 per cent a year.

Events: range from small winemakers' dinners to large tastings for 500 people. Our "taste and buy" *Classics Catalogue* events throughout the province have become extremely popular – customers taste a selection of products and have the opportunity to buy on-site.

Auction: In November 2002, VINTAGES staged Ontario's first commercial wine auction with Ritchie's Auctioneers & Appraisers, giving collectors a rare opportunity to buy or sell fine wines. The event generated $2.3 million in sales, exceeding expectations, and was enthusiastically received by participants. Another auction is planned for November 2003.

Web-based Initiatives: these include a Web site (*www.vintages.com*) where customers can find information on products and services; V-mail, a bi-monthly e-mail bulletin that updates subscribers on product releases and other news; and Virtual VINTAGES, a partnership with suppliers that allows customers to buy products directly from our suppliers' inventory.

Wines of the Month: highlights two featured products that offer exceptional value.

Looking Ahead

Plans for 2003–04 include:

- continue to enhance VINTAGES' product assortment through new or expanded programs such as In-store Discovery; VQA Discovery; Virtual VINTAGES; futures and pre-arrivals; and a revitalized *Classics Catalogue*
- continue to promote and demystify VINTAGES, especially for women and younger consumers
- provide more tasting opportunities to educate customers and take some of the perceived risk out of purchases
- improve business efficiencies and customer service by implementing new systems to support our programs
- collaborate with suppliers on assortment and promotion planning
- continue to implement programs to increase awareness and support of VQA products
- improve service, product availability and ordering processes for licensees.

Wines of Ontario

Sales of Ontario wines, especially VQA products, increased in both volume and value

A strategic partnership between the LCBO, the Ontario wine industry and the government of Ontario helped lift sales of Ontario wines in fiscal 2002–03, especially of products that bear the Vintners Quality Alliance (VQA) label.

The goals of the partnership are to build Ontario wines' market share in litres to 50 per cent over the next five years, including sales through winery retail stores and direct delivery to licensees, and support the industry's efforts to create a world-class brand.

As it developed its new five-year strategic plan, which took effect April 1, 2003, the LCBO aligned wherever feasible its goals and objectives with those of the industry's own five-year sales and marketing plan.

The results in fiscal 2002–03 were generally strong as sales of Ontario table wines, especially VQA wines, increased in both volume and value.

Here are some of the programs that contributed to increased sales in fiscal 2002–03.

WOW Leaders

Some 300 employees in larger LCBO stores have been trained as WOW Leaders, whose mandate is to help educate customers about the World of Ontario Wines (WOW) and to act as a resource to their colleagues. Chosen for their customer service skills and enthusiasm for Ontario wines, WOW Leaders receive extensive information and support from LCBO category managers and the industry, including tasting notes, a WOW newsletter, a guide to Ontario wineries and tastings and presentations by local winemakers.

Craft Winery Selection Program

This program helps smaller wineries establish their brands in some 60 LCBO stores with strong VQA sales. Sales of craft winery selections passed the $1-million mark during the first year of the program. Products that prove successful in their first year may "graduate" to regular Wines Category merchandising, making way for new products to enter the program.

Ontario Superstars

Each month, two VQA wines are promoted as the Wines Category's picks, to help customers choose Ontario wines with greater confidence. These "Ontario Superstars" are displayed prominently in stores and advertised in *Food & Drink* magazine. In the first four sales periods since its launch, featured brands sold 10,936 cases, compared to 6,737 cases last year – an increase of 62 per cent.

Increased Shelf Space/Presence in Stores

In February 2003, the government and the LCBO announced that the equivalent of 1.1 kilometres of shelf space for Ontario wines would be added in our stores. That's the equivalent of nearly 100 bottles for every LCBO store, though the amount varies from store to store, with newer, larger outlets offering more. For example, new stores in Toronto, Newmarket and St. Catharines offer all 378 Ontario wines regularly available through the LCBO, including 140 VQA wines; the store in St. Catharines store also offers tutored tastings and cooking demonstrations that showcase Niagara winemakers and chefs.

Program Support by Winery Size

Recognizing that Ontario wineries range greatly in size, and require varying degrees of support in the marketplace, the LCBO is weighing different options for wineries to participate in LCBO programs and promotions. This includes ways of entering the system, the need for new brand development, merchandising strategies and store distribution plans.

Reinventing the Ontario Wines Section

We are pilot-testing merchandising strategies that have proved successful in other liquor jurisdictions to see whether they might improve sales and market share of Ontario wines.

Right: the new Summerhill flagship store in Toronto offers all 378 Ontario wines regularly available through the LCBO, including 140 VQA wines, as do several other LCBO stores opened in fiscal 2002–03.

LCBO ONTARIO WINE SALES 2002–03

	Year over Year Growth in Litres	Year over Year Growth in Dollars
Ontario Non-VQA	2.2%	2.8%
Ontario VQA	12.6%	14.9%
Total Ontario Table Wines	4.0%	5.7%
Ontario Other	-7.4%	-4.0%
Grand Total Ontario	2.1%	4.1%

Note: Does not include sales through VINTAGES. Ontario Other includes sparkling wines, fortified wines, dessert wines and flavoured wine drinks, some of which are VQA.

Upgrading the Store Network

From Summerhill to Stouffville, improvements to the LCBO store network increase customer satisfaction and the return on our capital investment

On February 4, 2003, the LCBO's newest flagship store opened in a lovingly restored beaux-arts building on Yonge Street at Summerhill, which once housed the North Toronto Train Station.

Everyone who attended – customers, suppliers, government and industry officials, local historians – marvelled at the outstanding architectural features that were now revealed after being hidden for years by drywall and false ceilings.

They approved of how the heritage aspects of the building had been preserved by the developer, Equifund Corporation, as the site was converted to a state-of-the-art retail environment.

They browsed through nearly 5,000 products in all, including hundreds of fine Ontario wines and nearly 2,000 premium wines and spirits in an inviting VINTAGES section.

With 21,000 sq. ft. of selling space, and 31,000 sq. ft. in all, Store 10 – known simply as Summerhill – is Canada's largest liquor store.

Located in the heart of Rosedale, one of Toronto's – indeed Canada's – most affluent neighbourhoods, the store was created to serve some of the LCBO's most knowledgeable customers.

The staff of 80, which includes eight product consultants, received extensive training to help them provide compelling and responsible service to customers with high expectations.

The work that went into Summerhill was so extensive, and its profile so high, it's easy to forget that it was just one project in what was likely the busiest year ever for the LCBO's store development team. LCBO design co-ordinators, project managers, real estate specialists and others worked intensely throughout the year to build, renovate and refurbish dozens of stores in markets of all sizes across the province.

Experience shows that improved shopping environments – bigger, brighter and better located – not only increase customer satisfaction; many experience sales lifts of up to 30 per cent, with little or no cannibalization from other LCBO stores, provide a solid return on LCBO's capital investment and contribute to record dividend transfers.

In fiscal 2002–03, our investment in our retail stores was approximately $43 million, including maintenance and repairs:

- Seventeen new and relocated stores opened in Alliston, Collingwood, Markham, Mississauga, Newmarket, Ottawa-Nepean, Richmond Hill, St. Catharines, Stouffville and Toronto.
- Another 41 stores, including an older flagship store on Queens Quay in downtown Toronto, received cosmetic makeovers to bring colours, lighting and shelving up to current corporate standards.
- In smaller communities like Coe Hill, Gooderham, Lafontaine, Lion's Head, Port McNichol, Verner and Warsaw, aging trailer stores were replaced by permanent buildings that significantly expanded their shopping area and brand selection.

In all, some 150 of nearly 600 stores were upgraded in the past five years. Many were older stores that dated back to the era when liquor stores were purposely located on back streets. Backed by extensive market analysis, we now locate our stores on main roads, at busy intersections and in power centres where other leading retailers are found. Our stores are visible and accessible, with as much parking as we can offer, and interior layouts are designed to make shopping enjoyable, informative and convenient.

Over the next five years, our strategic plan calls for us to continue upgrading the store network. We'll open, expand and relocate stores in areas where populations are growing. We'll continue to do cosmetic upgrades throughout the province, improving lighting, layout and fixtures in a cost-effective manner, to extend our capital investment to as many stores as possible.

For fiscal 2003–04, renovation, relocation and expansion projects have been planned for Bells Corners, Brampton, Cambridge, Cookstown, Kitchener, London, Markham, Mississauga, Oakville, Oshawa, Toronto, Val Caron, Whitby and Woodbridge.

Between now and the end of 2008, we will spend $140 million to upgrade more than 200 stores, from flagships to mini-stores, looking at each market and each business case to ensure our investments pay dividends as they have in the past.

Top: staff members celebrate the reopening of our expanded store in Newmarket
Left: the new Summerhill flagship store, Toronto

Agency Store Expansion

This successful private-public partnership is making beverage alcohol shopping more convenient for residents, bringing additional revenue to smaller communities and increasing their overall business base

Since 1962, privately owned agency stores have provided beverage alcohol service to Ontario communities too small to support an LCBO or Beer Store outlet. Traditionally located in Northern Ontario, agency stores began opening in Southern Ontario in the 1990s, as this private-public partnership proved to be a safe, reliable and cost-effective way to deliver service to small communities.

In fiscal 2002–03, the network expanded by almost 50 per cent, from 105 stores to 155. Its sales increased accordingly, from $30 million to just over $42 million, about 1.5 per cent of total LCBO net sales.

The expansion is intended to make beverage alcohol shopping more convenient for residents, bring additional revenue to communities and increase their overall business base by giving rural consumers another reason to shop with local retailers.

LCBO stores that supply agencies also gain a significant wholesale client.

Agency store applicants must have an existing retail business in the community and commit to operating within established LCBO guidelines. The LCBO selects host operators through a public tender process. Potential hosts are assessed against a variety of criteria and selected based on a weighted ratings system designed to ensure the LCBO gets the best possible agent in each community.

Applications are reviewed by a committee that includes LCBO district managers and Head Office staff from Corporate Policy, Social Responsibility and Retail Planning. Successful applicants sign an agreement for up to five years, after which a new competition opens if it is recommended to continue to service the area with an agency store. In keeping with the LCBO's commitment to social responsibility, the program favours retail businesses that are less likely to attract minors. All staff who sell beverage alcohol must complete the same responsible server training as all LCBO retail employees.

LCBO store and district managers guide operators in setting up their product portfolios and ordering stock. With the expansion, many operators also received a fixtures package to give their beverage alcohol section a look and feel that is consistent with current LCBO retail standards.

Some agency stores carry as few as 70 brands but most carry around 150. The Beer Store supplies operators with beer produced in Ontario.

The program is expected to expand by another 66 stores in fiscal 2003–04.

Agency stores, like this one in Craighurst, make beverage alcohol shopping more convenient for residents and visitors in communities too small to support an LCBO store or Beer Store.

Supply Chain Improvements

For the LCBO, its suppliers, customers and stakeholders, the benefits of an improving supply chain are many

The multi-stage process that brings products from suppliers to retail stores is commonly referred to as the supply chain. The benefits of an improving supply chain are many:

- Frontline employees spend less time handling stock and more time serving customers, thus improving customer service, satisfaction and sales.
- We reduce costly excess inventory, which frees up funds that can be used to increase our dividend and to upgrade stores.
- We work more closely with suppliers to improve customer service, efficiency and profitability.
- Stores improve their assortments and product flow by combining a core of fast-moving, top-selling brands with products of interest to local tastes.

The LCBO worked on a number of fronts to improve its supply chain in fiscal 2002–03.

Store Service Project

We continued the rollout of a Store Service project, in which stores adopt new practices to improve supply chain processes, minimize unnecessary product handling and make product assortments more dynamic. To date, sales in supply chain stores have increased on average by two per cent over the corporate trend. More than 70 stores joined the project in 2002–03.

Collaborative Planning

In September 2002, the LCBO launched a formal planning process to more closely align our demand for products with suppliers' production schedules. The process was first tested with six vendors of various sizes and has since been expanded to 35. The three stages of the project are:

- **Promotional Planning**, in which LCBO and suppliers lay out promotional plans over an 18-month period, to help us better plan inventory and materials, allocate resources and identify opportunities to build sales, profits and respective brand images
- **Collaborative Planning, Forecasting and Replenishment**, designed to increase the accuracy of demand forecasts and replenishment plans
- **Joint Performance Scorecard**, to track the performance of the LCBO and vendors.

Information Sharing Program

Online reports help supplier agents track merchandise through the LCBO distribution network, so they can identify and resolve problems more quickly. First launched in early 2002, the program was expanded in fiscal 2002–03 to include 120 agents.

Localized Assortments

A key supply chain goal is to introduce a localized assortment into stores, to improve service and product flow. A component of the localized assortment is a "core" of products of proven interest to customers which they can find consistently and readily across the network. The core assortment is complemented by products that appeal to local customer preferences. Choices are based on demographic research, sales histories and the store staff's understanding of their clientele. In fiscal 2002–03, we completed localized assortments for nearly 100 stores.

Seasonal Inventory Strategy

LCBO sales generally experience predictable spikes at Christmas, Easter and, in resort areas, on summer long weekends. For Christmas 2002, we adopted a new approach to better manage the volume required to service stores, and found that stores were able to keep more products in stock, even with lower inventory levels than in previous years.

Logistics Network

The LCBO has five warehouses to service more than 1,000 stores – some 600 of its own and more than 400 Beer Stores. As LCBO sales have climbed from $2 billion to $3 billion a year, and the product mix has shifted from spirits and wine towards beer and coolers, which take up more space, our warehouses have come under increasing pressure. In fiscal 2002–03, warehouses in Toronto and London were upgraded and automated to increase throughput capacity. Plans were developed to expand the London facility so it can more than double its storage capacity and serve many more stores than at present. Improvements also began at the highly automated Durham facility east of Toronto, including software upgrades to improve product sortation and case tracking.

Web-based Ordering

In May 2002, LCBO introduced Web-based ordering to all stores and trained staff in its use. The program was designed to help staff reduce excess inventory while keeping shelves well-stocked. Category Management staff at Head Office also received training to help them forecast and replenish stock in LCBO warehouses with greater accuracy and efficiency.

Social Responsibility

As a responsible and caring retailer, we work on our own, and in partnership with other organizations, to make a difference in every community we serve

There's a Burlington man who doesn't shop at the LCBO any more – and we couldn't be happier.

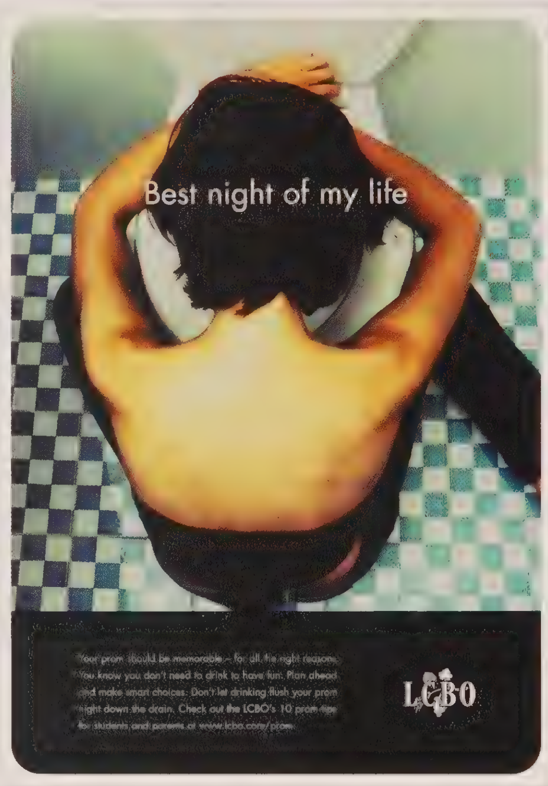
He had shopped at our Fairview Street store for years until Assistant Manager Milan Zrinscak refused to serve him one day because he appeared intoxicated.

The man recently returned after a prolonged absence to thank Zrinscak. He is now a member of Alcoholics Anonymous, he explained, in part because of what happened that day.

This outcome may seem exceptional, but the circumstances are not. Each year, LCBO employees challenge more than a million people in our stores, and refuse to serve tens of thousands, because they appear underage or intoxicated.

As a responsible and caring retailer, LCBO also creates and distributes materials on responsible hosting and personal consumption; advertises against impaired driving; raises funds for good causes; and conducts its business responsibly. We work on our own, and in partnership with other organizations, to make a difference in every community we serve.

Here are some initiatives we undertook in fiscal 2002–03 in these areas.



Challenge and Refusal

- LCBO employees challenged 1.1 million customers who appeared underage or intoxicated, or were believed to be buying alcohol for minors or intoxicated people.
- Nearly 70,000 people were refused service – about two-thirds of whom appeared underage and could not provide valid ID.
- We issued 4,394 tamper-resistant photo ID cards in fiscal 2002–03. Some 24,000 BYID cards have been issued since 1996.

Promoting responsible consumption

- LCBO published and distributed more than half a million copies of *HOST*, a guidebook designed to help customers entertain safely and responsibly. *HOST* provided responsible hosting and party planning information, facts about alcohol consumption and liability, non-alcoholic "mocktail" recipes and much more. Customized versions were created for six other Canadian liquor jurisdictions.

- We promoted prom safety, publishing tips for students and their parents, and a poster reminding young people they don't need to drink to have fun (page 40). The poster was sent to high schools across Ontario and was displayed in all LCBO stores during prom season. Tips for students and parents were available in stores, on the LCBO Web site (*www.lcbo.com*) and via our toll-free Infoline (1-800-ONT-LCBO).
- The LCBO and the Ottawa Senators collaborated on events to promote social responsibility. Highlights included a poster and public service announcements against drinking and driving, featuring Senators players and aired in the Corel Centre.
- We partnered with the Ontario Association of Chiefs of Police to raise awareness of the RIDE program, and with the Ontario Community Council on Impaired Driving to promote strategies against impaired driving.
- We helped the Ministry of Transportation inform the public about its Ignition Interlock Program.
- We also supported student-led initiatives against impaired driving.

Advertising

- A new TV commercial, created in partnership with MADD Canada, encouraged people to stop drinking and driving – any way they can. The commercial showed a party host taking car keys away from a guest intent on driving after drinking. When the guest protests, the host drops the keys down his pants and dares the guest to retrieve them.
- Five ads created for *FOOD & DRINK* featured LCBO employees who embody our commitment to quality, charity, community, customer service and social responsibility.
- All stores received materials to help them place social responsibility ads in local media, to promote responsible use of alcohol and deter impaired driving and underage drinking.

Fundraising

Highlights this fiscal year included:

- more than $350,000 collected for MADD Canada and other good causes through donation boxes at checkouts
- another $130,000 raised for the United Way through employee donations and special events
- $117,000 raised for We Care, to help send children with disabilities to summer camp
- $75,000 raised for Camp Oochigeas, which provides summer getaways to kids with cancer
- more than $100,000 from the sale of compilation CDs, gift-wrap programs and events staged by employees on behalf of local charities.

Environment

- LCBO contributed $5 million to help Ontario municipalities cover costs of recycling beverage alcohol containers through the Blue Box system. Since 1998, the LCBO has contributed $21 million to municipalities to help cover such costs, and will contribute $20 million more over the next four years.
- Wherever possible, we recycle corrugated cardboard, fine paper, polystyrene, bottles, cans, newspapers, batteries, printer cartridges, data tapes and other materials.
- We require suppliers to minimize packaging and often provide printing services to non-profit environmental organizations such as the Recycling Council of Ontario and Pollution Probe.

Milan Zrinscak
Assistant Manager, Store 566, Burlington

Public Sector Disclosure Act

The *Public Sector Disclosure Act*, passed by the Ontario Legislature in 1996, is designed to make the public sector more open and accountable to taxpayers. The Act requires Ontario's public sector organizations, including LCBO, to disclose annually the names, positions, salaries and taxable benefits of employees whose employment income is $100,000 or more a year. In keeping with the requirements of the Act, LCBO submits the following information for calendar 2002.

There are 60 LCBO names on this year's *Public Sector Disclosure Act* list, compared to 52 the year before. Eight employees appear for the first time, due to normal salary progression through their pay grade; additional pay received for acting assignments during the 2002 calendar year; unused Management Compensation Option (MCO) days taken as cash in lieu of days off (most management staff are eligible to receive five MCO days a year); or pay-for-performance bonuses that help LCBO attract and retain the high level of executive talent it needs to meet its strategic and business objectives.

Name	Position	Employment Income	Taxable Benefits
Ashdown, Tony	Director, Human Resources Development	$117,228.46	$276.81
Bartucci, Ron	Director, Traffic, Customs & Excise	$108,091.22	$263.29
Bonic, Jacqueline	VP, Store Development & Real Estate	$146,099.62	$335.76
Bourre, Don	Director, Eastern Region	$122,698.27	$1,151.89
Brandt, Andrew	Chair & CEO	$125,035.77	$5,000.00
Browning, J. Alex	Sr. VP, Finance & Administration	$166,485.04	$9,949.79
Buck, Peter	Director, Human Resources Services	$138,052.86	$317.31
Burns, Tamara	VP, Merchandising	$146,895.76	$342.84
Cardinal, Nancy	VP, Marketing Communications	$147,099.62	$335.76
Chu, Hang-Sun	Sr. Systems Analyst	$103,481.51	$211.11
Clevely, Robert	Director, Central Region	$100,957.77	$1,186.06
Collins, Robert	Director, Customer Insights	$122,462.43	$282.19
Davio, Robert	Manager, Pricing Administration	$102,581.62	$259.02
Downey, Robert	Sr. VP, Sales & Marketing	$160,028.42	$9,937.99
Dutton, Rob	Dir., Fin. Planning & Development	$146,099.62	$335.76
Ecker, Roy	VP, Operations	$158,171.79	$4,445.36
Farrell, Michael	Director, Commercial Customer Services	$135,335.86	$317.31
Fisher, Ron	Director, Western Region	$143,474.26	$339.51
Fitzpatrick, Mary	Sr. VP, Gen. Counsel & Corp. Secretary	$166,485.04	$9,949.79
Gee, Larry*	Executive VP & COO	$218,286.39	$128.28
Grant, Keith	Director, Special Projects	$101,198.01	$275.00
Green, Michael	Solicitor	$131,913.93	$317.31
Holloway, Brian	Director, Application Systems	$133,158.93	$317.31
Kane, Murray	Sr. VP, Human Resources	$166,485.04	$9,949.79
Kelly, Hugh	Sr. VP, Information Technology	$166,485.04	$9,949.79
Kennedy, Bill	Exec. Director, Corp. Communications	$146,099.62	$335.76
Ker, Gerry	Exec. Director, Corporate Policy	$142,186.58	$323.31
Lamantia, Mark	Sr. Systems Analyst	$105,045.82	$211.11
Landy, Randi	Director, Beers & Special Markets	$114,920.26	$283.23
Lyons, Carol	Controller	$135,335.86	$317.31
MacGregor, Maralisa	Director, Supply Chain	$147,235.11	$313.95
Marshall, Dave	Director, Northern Region	$138,052.86	$1,164.31
Martin, John	Sr. VP, Logistics	$161,315.81	$9,949.79
McGrath, Bruce	Sr. Systems Analyst	$105,465.33	$211.11
McNee, Andrew	Solicitor	$122,266.06	$303.72
Misetich, David	Inventory Manager	$107,736.77	$248.22
Mogk-Edwards, Shari	Category Director, Spirits	$114,920.26	$283.23
Murphy, Peter	Director, Conventional Warehousing	$135,335.86	$317.31
Mutlak, Teresa	Dir., Financial Reporting & Technology	$105,905.26	$265.53
O'Brien, Barry	Director, Corporate Affairs	$120,861.64	$277.71
Peter, N. Robert	President and COO	$211,172.13	$10,911.01
Pizzolato, Bruce	Director, Durham Facility	$115,251.05	$291.60
Ramsay, Gary	Director, Application Systems	$135,335.86	$317.31
Renton, Alison	Solicitor	$136,672.20	$316.95
Russell, Kevin	Manager, Retail Planning	$100,429.75	$237.54
Salvisburg, Nanci	Director, Customer Service & Admin.	$132,957.06	$507.95
Schmidt, Linda	Inventory Manager	$102,331.69	$250.74
Sherwood, Garfield	Sr. VP, Retail	$166,485.04	$5,163.25
Soleas, George	VP, Quality Assurance	$139,704.84	$326.28
Stanley, Thomas	Director, IT Infrastructure	$101,002.53	$253.03
Stephens, Mike	District Manager	$103,616.10	$323.37
Sutton, Shelley	Director, Strategic Planning	$120,602.49	$277.71
Tughan, William	Director, Resource Protection	$118,483.64	$277.71
Turner, Jim	Director, Western Region	$122,698.27	$435.89
Van Kessell, Renee	Solicitor	$126,743.54	$314.79
Walker, R. Lila	Director, Compensation & HR Admin.	$118,291.17	$276.81
Whitelaw, Richard	Treasurer	$126,204.98	$308.37
Wilson, Tom	VP, VINTAGES	$143,224.62	$335.76
Yazejian, Levon	Director, General Audit	$118,955.87	$277.71
Zachar, Wayne	Director, Employee Relations	$138,052.86	$317.31

*retired

Responsibility for Financial Reporting

The accompanying financial statements of the Liquor Control Board of Ontario have been prepared in accordance with accounting principles generally accepted in Canada, and are the responsibility of management. The preparation of financial statements necessarily involves the use of estimates based on management's judgment, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been properly prepared within reasonable limits of materiality and in light of information available up to June 13, 2003.

Management is responsible for the integrity of the financial statements and maintains a system of internal controls designed to provide reasonable assurance that the assets are safeguarded and that reliable financial information is available on a timely basis. The system includes formal policies and procedures and an organizational structure that provides for appropriate delegation of authority and segregation of responsibilities. An internal audit function independently evaluates the effectiveness of these internal controls on an ongoing basis and reports its findings to management and the Audit and Governance Review Committee of the Board.

The Board, through the Audit and Governance Review Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. The Audit and Governance Review Committee, comprised of three Members who are not employees/officers of the LCBO, meets periodically with management, the internal auditors and the Provincial Auditor to satisfy itself that each group has properly discharged its respective responsibility, and to review the financial statements before recommending approval by the Board.

The financial statements have been audited by the Provincial Auditor. The Provincial Auditor's responsibility is to express an opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles. The Auditor's Report, which appears on page 54, outlines the scope of the Auditor's examination and opinion.

On behalf of management:

J. C. Browning

J. Alex Browning
Senior Vice President, Finance & Administration, and Chief Financial Officer
June 13, 2003

Financial Overview

KEY INDICATORS: 1999–2003

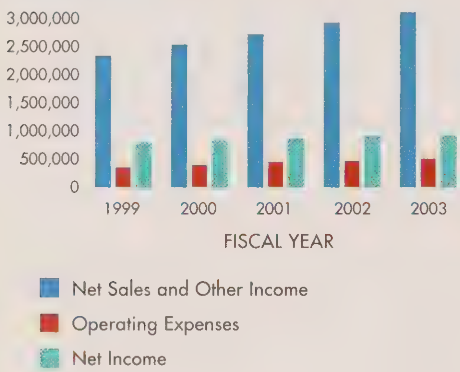
The following table lists three of the most important variables related to the operations of the LCBO: number of stores, permanent employees and regular products listed.

OPERATIONS

	1999	2000	2001	2002	2003
Number of LCBO Stores	600	602	600	599	597
Number of Permanent Employees	3,014	3,074	3,174	3,225	3,362
Number of Regular Products Listed	3,366	3,496	3,478	3,487	3,476

The critical financial variables of net sales and other income, operating expenses and net income are given in the following table.

FINANCIAL INDICATORS: 1999–2003 (values in $000s)

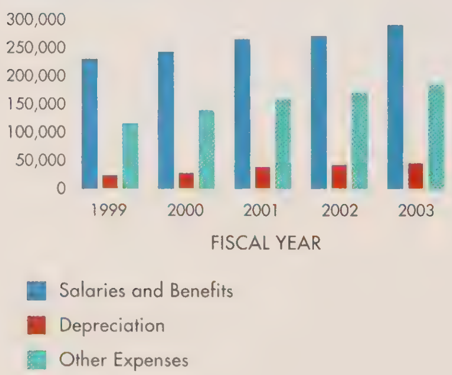


FINANCIAL (values in $000s)

	1999	2000	2001	2002	2003
Net Sales and Other Income	2,349,832	2,549,458	2,734,937	2,939,563	3,119,240
% Change/Previous Year	8.75%	8.50%	7.28%	7.48%	6.11%
Operating Expenses	374,558	414,861	468,090	489,633	525,959
As a % of Net Sales & Other Income	15.94%	16.27%	17.12%	16.66%	16.86%
Net Income	809,425	845,694	876,272	920,913	939,542
As a % of Net Sales & Other Income	34.45%	33.17%	32.04%	31.33%	30.12%

Note: The LCBO refers to sales in three different ways: first, gross sales which include the federal Goods and Services Tax and the Provincial Sales Tax; second, net sales which exclude the two sales taxes and any relevant discounts (e.g., the discounts provided to licensees by the LCBO); and third, net sales also excluding any sales through the LCBO Private Stock Program. The Net Sales and Other Income line listed in the table consists of net sales plus any other income (e.g., interest on investments). Gross sales are given in the LCBO Sales Channel Summary on page 48.

OPERATING EXPENSES: 1999–2003 (values in $000s)



BREAKDOWN OF OPERATING EXPENSES (values in $000s)

	1999	2000	2001	2002	2003
Salaries and Benefits	231,486	244,399	266,929	272,594	291,762
Depreciation	25,580	29,582	40,546	44,260	47,602
Other Expenses	117,492	140,880	160,615	172,779	186,595
Total Operating Expenses	374,558	414,861	468,090	489,633	525,959

The following tables show the breakdown of LCBO revenue payments for the last five years to the federal, provincial and municipal governments.

TREASURER OF ONTARIO (values in $000s)

	1999	2000	2001	2002	2003
Remitted by the Liquor Control Board: on account of profits	780,000	800,000	850,000	905,000	975,000
Remitted by the Liquor Control Board: Ontario Retail Sales Tax on sales through liquor	220,645	239,071	255,347	275,072	288,884
Remitted by the Alcohol and Gaming Commission:* on account of licence fees and permits	519,472	537,569	524,110	530,799	526,650
Remitted by others:** Ontario Retail Sales Tax on sales through Beer Stores and Ontario Winery Retail Stores	168,281	177,406	177,302	186,308	194,320
Ontario Retail Sales Tax on sales through agency stores	3,305	3,672	3,847	4,027	5,596
Total	**1,691,703**	**1,757,718**	**1,810,606**	**1,901,206**	**1,990,450**

* The Alcohol and Gaming Commission of Ontario (AGCO), The Beer Store and Ontario winery stores are separate, non-LCBO businesses.

** Revenue payments from these entities are recorded by the LCBO and presented here in the interest of providing a global perspective of beverage alcohol retailing in Ontario.

RECEIVER GENERAL FOR CANADA (values in $000s)

	1999	2000	2001	2002	2003
Remitted by the Liquor Control Board: Excise taxes and Customs duties	249,639	267,137	278,430	284,520	294,203
Goods and Services Tax (GST)	66,192	69,718	79,056	84,885	97,459
Remitted by others: Excise taxes, GST and other duties/taxes	333,407	367,637	361,917	355,868	303,508
GST remitted on sales through agency stores	1,928	2,142	2,244	2,349	3,264
Total	**651,166**	**706,634**	**721,647**	**727,622**	**698,434**

ONTARIO MUNICIPALITIES (values in $000s)

	1999	2000	2001	2002	2003
Remitted by the Liquor Control Board: grants in lieu of realty and business taxes	3,680	3,569	3,671	3,423	2,755
Total Revenue Payments	**2,346,549**	**2,467,921**	**2,535,924**	**2,632,251**	**2,691,639**

Note: These amounts do not include corporation, realty and business taxes paid by distilleries, wineries, breweries and licensees. Ontario Retail Sales Tax collected by licensees and agency stores on sales of beverage alcohol is excluded from these figures. The 2003 figures for Remitted by others are slightly understated due to several brewers not reporting financial information at the time of publication. Ontario Retail Sales Tax and Goods and Services Tax remitted on sales through agency stores are estimates.

LCBO VOLUME SALES (in 000s Litres)

Product Type	1999	2000	2001	2002	2003
Domestic Spirits	31,834	33,310	34,286	33,897	33,570
Domestic Spirit Coolers	16,168	17,361	16,789	25,791	29,076
Imported Spirits	15,175	17,491	18,851	20,866	23,434
Total Spirits	**63,177**	**68,162**	**69,926**	**80,554**	**86,080**
Domestic Wine	25,795	26,523	26,958	28,445	29,912
Domestic Wine Coolers	544	489	499	549	426
Imported Wine	52,952	57,010	60,626	63,339	66,732
Total Wine	**79,291**	**84,022**	**88,083**	**92,333**	**97,070**
Domestic Beer	61,377	65,618	67,677	75,046	79,290
Domestic Beer Coolers	38	339	627	363	108
Imported Beer	55,827	64,451	73,756	83,337	92,242
Total Beer	**117,242**	**130,408**	**142,060**	**158,746**	**171,640**
Total Domestic	**135,756**	**143,640**	**146,836**	**164,091**	**172,382**
Total Imported	**123,954**	**138,952**	**153,233**	**167,542**	**182,408**
Total	**259,710**	**282,592**	**300,069**	**331,633**	**354,790**

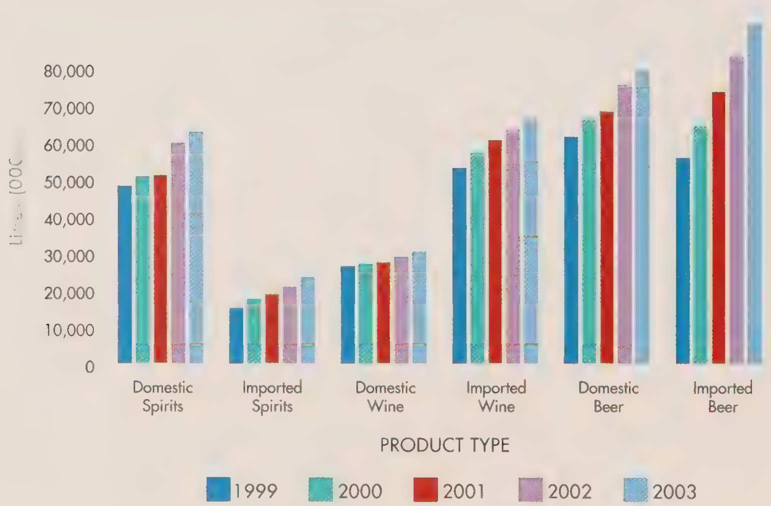
Product Type	1999	2000	2001	2002	2003
Sales by Ontario Winery Stores	13,878	14,074	14,961	16,235	16,717
Sales by The Beer Store & On-site Brewery Stores	654,413	663,806	643,721	651,548	653,087

Note: LCBO beer sales figures include LCBO sales to The Beer Store (TBS). The 2003 figures for sales by TBS and on-site stores are unaudited and understate total sales due to several brewers not reporting financial statements at the time of publication.

Note: 2002 figures have been restated.

SHARE OF VOLUME SALES

LCBO VOLUME SALES BY PRODUCT TYPE: 1999-2003



Note: In this chart, Domestic Spirits, Domestic Wine and Domestic Beer include sales of coolers.

SHARE OF VALUE SALES

LCBO VALUE SALES (in $000s)

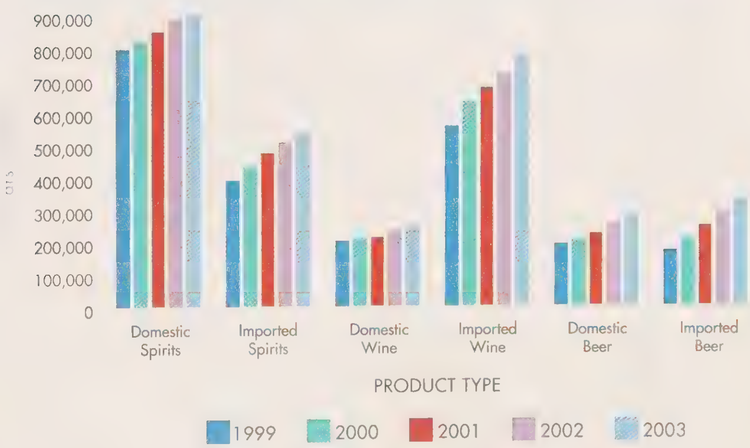
Product Type	1999	2000	2001	2002	2003
Domestic Spirits	717,270	739,313	771,487	764,567	761,589
Domestic Spirit Coolers	80,716	84,579	82,354	125,869	142,410
Imported Spirits	391,872	435,093	476,972	510,080	537,838
Total Spirits	**1,189,858**	**1,258,985**	**1,330,813**	**1,400,516**	**1,441,837**
Domestic Wine	201,723	211,595	214,443	234,238	249,272
Domestic Wine Coolers	1,976	1,797	1,954	2,134	1,606
Imported Wine	559,624	635,112	680,993	724,784	783,045
Total Wine	**763,323**	**848,504**	**897,390**	**961,156**	**1,033,923**
Domestic Beer	194,149	208,882	225,612	254,218	274,324
Domestic Beer Coolers	144	1,035	2,076	1,198	420
Imported Beer	174,284	210,815	252,221	295,426	339,926
Total Beer	**368,577**	**420,732**	**479,909**	**550,842**	**614,670**
Total Domestic	**1,195,978**	**1,247,201**	**1,297,926**	**1,382,224**	**1,429,621**
Total Imported	**1,125,780**	**1,281,020**	**1,410,186**	**1,530,290**	**1,660,809**
Non-Liquor	**3,914**	**5,389**	**6,213**	**7,782**	**7,260**
Total	**2,325,672**	**2,533,610**	**2,714,325**	**2,920,296**	**3,097,690**

Product Type	1999	2000	2001	2002	2003
Sales by Ontario Winery Stores	111,765	118,219	123,739	137,994	146,457
Sales by The Beer Store	1,937,004	2,021,111	2,062,297	2,174,248	2,245,378

Note: Value sales listed above for the LCBO and Ontario Winery Stores consist of net sales. Sales values for The Beer Store consist of net sales plus GST. Category totals provided here include sales through VINTAGES and the LCBO Private Stock Program, and therefore do not match the totals found in the Product Trends sections of this Annual Report.

Note: 2002 figures have been restated.

LCBO VALUE SALES BY PRODUCT TYPE: 1999-2003



Note: In this chart, Domestic Spirits, Domestic Wine and Domestic Beer include sales of coolers

PRODUCT LISTINGS

	1999	2000	2001	2002	2003
Domestic					
Spirits	539	518	542	486	460
Wine	538	536	499	481	469
Beer	385	403	407	426	444
Imported					
Spirits	601	586	641	672	652
Wine	1,085	1,192	1,113	1,164	1,187
Beer	218	261	276	258	264
Total Regular Listings	**3,366**	**3,496**	**3,478**	**3,487**	**3,476**
VINTAGES Wines and Spirits	3,235	3,569	3,108	2,858	3,127
Duty-Free Listings	210	235	212	224	240
Consignment Warehouse and Private Stock	5,241	6,106	6,225	5,444	6,813
Total Product Listings	**12,052**	**13,406**	**13,023**	**12,013**	**13,656**

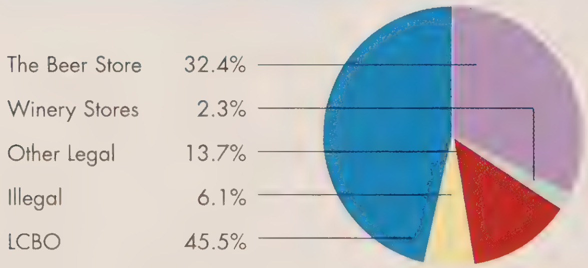
Note: The total number of regular products listed has been restated to reflect products listed for the entire fiscal year, rather than products listed in the LCBO Winter Price Book, as had previously been the case. Product listing figures for Consignment Warehouse and Private Stock are estimates based on invoices produced by Specialty Services. The total does not include products delisted during the fiscal year.

LCBO SALES CHANNEL SUMMARY (in $000s)

	1999	2000	2001	2002	2003
LCBO Total Sales	2,725,858	2,967,710	3,177,916	3,417,729	3,622,049
The Beer Store Total Sales	2,214,918	2,324,225	2,381,289	2,522,993	2,607,077
Winery Retail Stores Total Sales	133,001	140,681	147,178	162,539	174,284
Other Channels:					
Legal	888,670	941,465	1,000,660	1,017,104	957,073
Homemade	63,567	59,070	49,025	48,013	50,852
De-alcoholized Beer	23,872	22,314	20,870	20,191	19,125
Illegal	542,896	455,801	405,918	432,435	455,529
Grand Total	**6,592,782**	**6,911,266**	**7,182,856**	**7,621,004**	**7,885,989**

Note: All figures above are shown in gross sales. The numbers included in the Other Channels category are estimates. LCBO and The Beer Store figures are slightly overstated due to reciprocal sales included in the totals. These sales are excluded in the charts below.

VALUE BY SALES CHANNEL

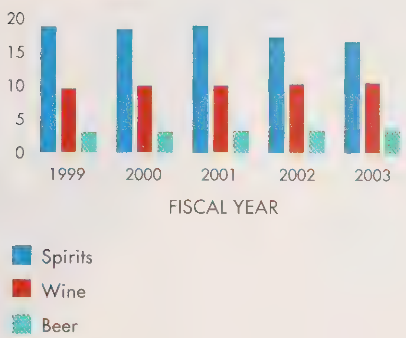


AVERAGE LCBO RETAIL PRICES PER LITRE

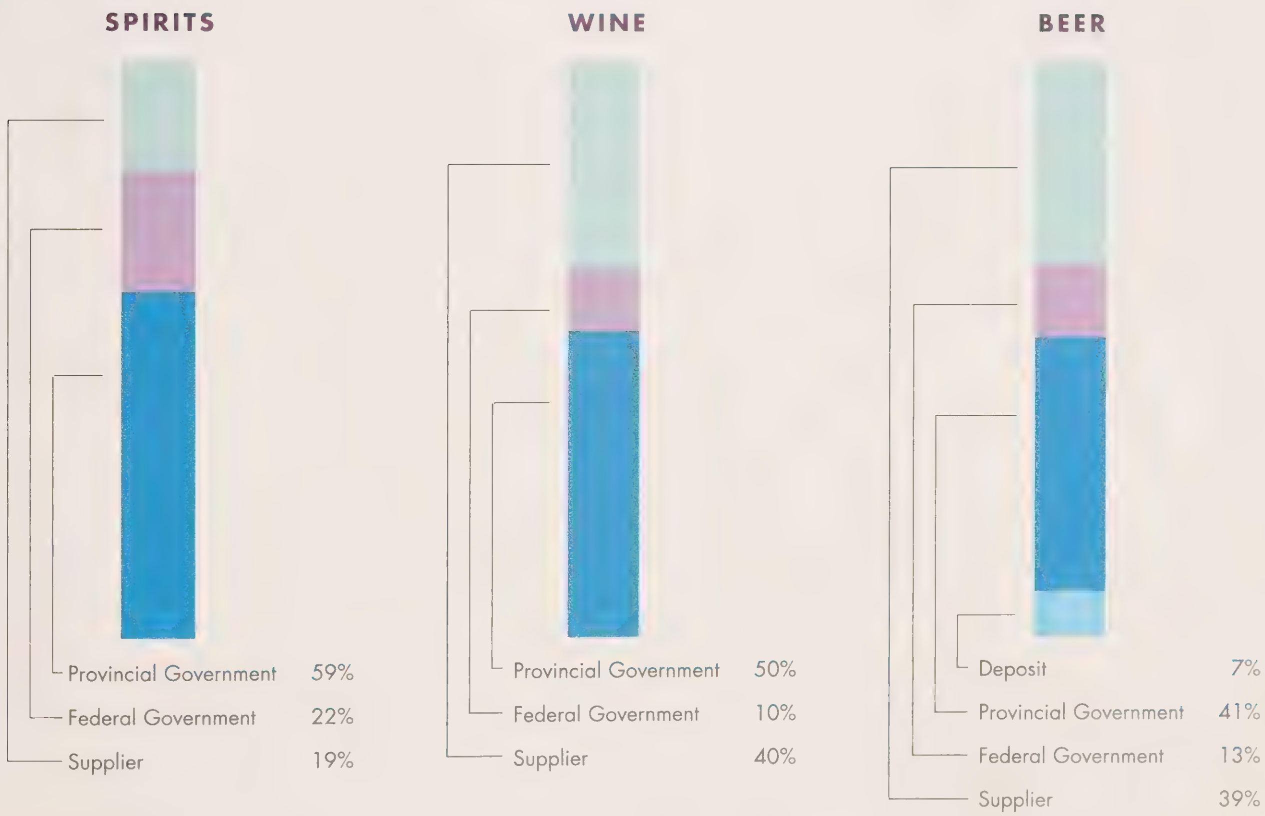
Product Type	1999	2000	2001	2002	2003
Spirits	$18.83	$18.47	$19.03	$17.39	$16.75
Wine	$9.63	$10.10	$10.19	$10.41	$10.65
Beer	$3.14	$3.23	$3.38	$3.47	$3.58
Average Transaction Value per Customer	$28.07	$29.55	$30.51	$31.05	$31.90

Note: Retail prices exclude GST and PST. For all categories, coolers are included.

AVERAGE LCBO RETAIL PRICES PER LITRE 1999-2003



REVENUE DISTRIBUTION



The tables below show the share of volume sales held by various segments within major product categories.

PRODUCT CATEGORY SHARE

Canadian Spirits	1999	2000	2001	2002	2003
Canadian Whisky	30.4%	29.9%	30.3%	25.6%	24.0%
Canadian Rum	14.5%	14.5%	14.7%	12.6%	11.9%
Canadian Vodka	14.3%	14.2%	14.6%	12.7%	12.2%
Spirit Coolers	33.5%	34.3%	32.9%	43.2%	46.4%
Canadian Dry Gin	2.2%	2.1%	2.1%	1.6%	1.3%
Other	5.1%	5.0%	5.4%	4.3%	4.2%
Imported Spirits					
Scotch	23.8%	22.0%	20.2%	18.1%	16.3%
Liqueur	18.7%	18.2%	17.8%	15.6%	13.6%
Miscellaneous Liquors	13.2%	13.5%	13.6%	13.9%	12.8%
Vodka	13.9%	15.5%	16.0%	15.7%	15.0%
French Brandy	9.4%	9.0%	8.8%	8.0%	7.5%
Spirit Coolers	0.1%	0.6%	2.5%	8.6%	16.7%
Other	20.9%	21.2%	21.1%	20.1%	18.1%
Canadian Wines					
White Table	48.6%	48.4%	48.4%	49.2%	49.8%
Red Table	22.3%	24.1%	25.7%	26.6%	28.4%
7% Sparkling	6.1%	6.2%	5.6%	5.5%	5.3%
Sherry	4.5%	4.4%	4.5%	4.6%	4.5%
Wine Coolers	3.8%	1.8%	1.7%	1.9%	1.7%
Other	14.7%	15.1%	14.1%	12.2%	10.3%
Imported Wines					
White Table	42.3%	39.6%	37.6%	36.4%	34.7%
Red Table	43.2%	44.4%	46.3%	47.4%	49.4%
Champagne	4.1%	4.6%	3.5%	3.5%	3.4%
Sherry	1.3%	1.1%	1.0%	0.9%	0.8%
Other	9.1%	10.3%	11.6%	11.8%	11.7%
Canadian Beer					
Ontario Beer	92.4%	91.3%	88.4%	87.3%	85.3%
Other Canadian Beer	7.6%	8.7%	11.6%	12.7%	14.7%
Imported Beer					
U.S. Beer	41.8%	36.9%	31.0%	25.1%	18.5%
Other Imported Beer	57.9%	62.9%	68.8%	74.7%	81.3%
Saké	0.3%	0.2%	0.2%	0.2%	0.2%

The following table shows detailed sales of wine by volume and value (LCBO sales only).

VOLUME (000s litres)

Product Type	2000	2001	2002	2003
Red Wine	31,012	34,100	36,421	39,699
White Wine	34,913	35,189	35,786	36,072
Rosé Wine	3,264	2,984	2,934	2,878
Sparkling Wine	4,704	3,894	3,892	3,858
Fortified Wine	3,373	3,457	3,400	3,328
Wine Coolers	947	868	812	654
Other Wine	3,968	5,358	5,564	5,533
VQA Wines*	3,158	3,659	3,933	4,387

VALUE ($000s)

Product Type	2000	2001	2002	2003
Red Wine	347,051	390,289	430,867	478,088
White Wine	312,901	319,344	330,730	340,611
Rosé Wine	27,699	25,091	24,703	24,236
Sparkling Wine	70,310	52,914	53,161	55,451
Fortified Wine	32,995	34,691	33,918	33,919
Wine Coolers	4,454	3,970	3,594	2,883
Other Wine	30,024	42,858	45,354	46,258
VQA Wines*	41,259	47,770	50,205	56,445

* VQA wine sales are reported in a separate consolidated total and also within each wine product category.

Note: Sales figures of wine by volume and value exclude Private Stock sales.

The following table shows LCBO spirits sales by country of origin for fiscal 2002–03.

SPIRITS 2002–03

Country	NET SALES	LITRES
Canada	$902,631,132	62,603,065
Great Britain	$172,916,983	8,953,606
France	$83,069,222	2,554,192
U.S.A.	$55,595,571	2,743,946
Ireland	$51,132,114	1,869,612
Sweden	$36,369,644	1,778,601
Mexico	$31,900,354	1,011,933
Italy	$31,579,128	1,316,392
Finland	$11,623,857	528,730
Russian Federation	$7,991,423	370,814
Germany	$7,966,248	305,391
Poland	$6,778,339	287,793
Jamaica	$4,870,104	183,189
Barbados	$4,362,927	181,185
Greece	$3,750,318	170,955
South Africa	$3,226,711	130,765
Switzerland	$2,908,097	92,517
Netherlands	$2,731,208	129,668
New Zealand	$1,898,224	271,169
Cuba	$1,447,594	54,490
Portugal	$1,105,407	39,907
Bermuda	$1,051,623	39,206
Croatia	$849,951	33,711
Puerto Rico	$804,719	31,069
Austria	$657,127	14,117
Hungary	$619,873	25,658
Spain	$614,838	26,240
Bahamas	$333,842	10,710
Denmark	$327,942	14,257
Lebanon	$322,758	13,024
Guyana	$320,938	11,050
Ukraine	$262,331	11,075
Czech Republic	$245,093	7,351
India	$231,700	10,068
People's Republic of China	$219,820	10,857

SPIRITS CONTINUED

Country	NET SALES	LITRES
Belgium	$133,609	5,493
Brazil	$94,225	3,793
Israel	$83,931	3,581
Republic of Yugoslavia	$62,456	1,612
Chile	$58,955	2,141
Trinidad	$51,812	2,342
Philippines	$15,950	697
Cyprus	$11,330	522
Norway	$10,392	260
Bolivia	$9,980	421
Georgia	$8,517	150
Macedonia	$4,777	199
Peru	$2,794	78
Australia	$1,191	15
Antigua	$323	14
Total	**$1,433,267,402**	**85,857,631**

The following table shows LCBO wine sales by country of origin for fiscal 2002–03.

WINE 2002-03

Country	NET SALES	LITRES
Canada	$222,659,319	27,510,870
France	$199,168,048	17,068,646
Italy	$169,834,090	15,757,084
Australia	$129,688,693	8,730,535
U.S.A.	$98,603,028	8,482,126
Chile	$42,912,449	4,105,818
Germany	$20,604,079	1,980,873
Portugal	$20,419,057	1,703,093
Spain	$19,955,251	1,581,921
South Africa	$16,533,974	1,576,265
New Zealand	$7,336,419	434,166
Argentina	$5,671,695	585,710
Greece	$4,582,420	577,751
Hungary	$3,273,052	432,568
Great Britain	$2,829,538	600,824
Bulgaria	$2,720,518	347,096
Republic of Yugoslavia	$914,266	115,624
Croatia	$665,460	75,651
Israel	$598,547	55,702
Austria	$427,772	33,268
Mexico	$383,917	36,911
Poland	$340,681	22,492
Jamaica	$320,365	32,988
Lebanon	$259,569	15,321
Romania	$248,959	30,860
Denmark	$201,455	17,721
Macedonia	$186,643	25,081
Japan	$179,412	14,267
Slovenia	$141,301	18,734
Cyprus	$126,739	11,669
Switzerland	$124,587	5,689
Morocco	$82,882	9,177
Republic of Moldova	$65,257	7,357
Uruguay	$60,529	6,639
Estonia	$48,014	4,660
Belgium	$17,660	887
People's Republic of China	$16,401	1,720
Georgia	$12,557	938
Czech Republic	$812	124
Turkey	$6	2
Total	$972,215,421	92,018,828

The following table shows LCBO beer sales by country of origin for fiscal 2002–03.

BEER 2002-03

Country	NET SALES	LITRES
Canada	$271,021,961	76,876,384
Netherlands	$75,636,144	17,791,929
Mexico	$73,254,828	16,737,033
U.S.A.	$59,685,428	18,430,840
Germany	$28,149,642	7,912,[illegible]
Great Britain	$15,322,211	4,071,606
Belgium	$13,171,798	2,958,633
Ireland	$12,956,369	2,941,062
Denmark	$8,482,721	2,663,770
Poland	$8,336,934	2,474,219
Czech Republic	$5,016,432	1,369,898
Japan	$2,925,277	656,804
Trinidad	$1,293,871	326,407
Jamaica	$1,271,719	334,185
People's Republic of China	$1,203,798	327,093
Singapore	$625,185	190,189
Brazil	$593,880	131,014
Italy	$550,468	138,556
Portugal	$523,369	140,389
South Africa	$378,729	116,110
New Zealand	$334,755	89,867
Ukraine	$280,679	78,221
Philippines	$260,108	76,610
Thailand	$227,624	53,434
Cuba	$171,414	39,694
Croatia	$149,450	41,539
Greece	$132,366	33,597
Austria	$115,915	34,794
Slovakia	$115,479	39,779
Kenya	$86,264	20,164
Russian Federation	$86,147	23,997
Cyprus	$45,097	10,724
Australia	$42,641	9,994
Spain	$40,034	9,939
India	$37,231	8,802
France	$28,445	3,745
Lebanon	$28,301	7,006
Israel	$39	11
Panama	$7	2
Total	$582,582,760	157,170,767

Note: Net value represents net sales, excluding Private Stock sales. In fiscal 2002–03, the LCBO sold products from 65 different countries.

Auditor's Report

I have audited the balance sheet of the Liquor Control Board of Ontario as at March 31, 2003 and the statements of income and retained income and of cash flows for the year then ended. These financial statements are the responsibility of the Board's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Board as at March 31, 2003, the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Erik Peters, FCA
Provincial Auditor
Toronto, Ontario
June 13, 2003

Balance Sheet As at March 31, 2003

ASSETS (in $000s)	2003	2002
Current		
Cash and cash equivalents	46,385	80,108
Accounts receivable, trade and others	22,365	19,298
Inventories	247,523	226,285
Prepaid expenses	6,619	8,337
	322,892	**334,028**
Long-term		
Capital assets (Note 5)	225,045	197,895
	547,937	**531,923**
LIABILITIES AND RETAINED INCOME		
Current		
Accounts payable and accrued liabilities	262,140	216,518
Current portion of accrued benefit obligation (Note 3)	4,508	3,525
	266,648	**220,043**
Long-term		
Accrued benefit obligation (Note 3)	32,891	28,024
Retained income	248,398	283,856
	547,937	**531,923**

Commitments and Contingencies (Notes 6 and 8)

See accompanying notes to financial statements.

Approved by:

Andrew S. Brandt
Chair and Chief Executive Officer

Thom A. Bennett
LCBO Board Member; Chair, Audit and Governance Review Committee

STATEMENT OF INCOME AND RETAINED INCOME

Year ended March 31, 2003

(in $000s)	2003	2002
Sales and other income	**3,119,240**	**2,939,563**
Costs and expenses		
Cost of sales	1,653,739	1,529,018
Retail stores and marketing	360,448	344,759
Warehousing and distribution	64,431	54,137
Administration	53,478	46,477
Amortization	47,602	44,260
	2,179,698	**2,018,651**
Net income for the year	939,542	920,912
Retained income, beginning of year	283,856	267,944
	1,223,398	**1,188,856**
Deduct: Dividend paid to Province of Ontario	970,000	901,000
Deduct: Payment to municipalities on behalf of the Province of Ontario (Note 9)	5,000	4,000
	975,000	**905,000**
Retained income, end of year	**248,398**	**283,856**

See accompanying notes to financial statements.

STATEMENT OF CASH FLOWS Year ended March 31, 2003

(in $000s)	2003	2002
Cash provided from operations		
Net income	939,542	920,912
Amortization	47,602	44,260
Gain (Loss) on sale of capital assets	(1,306)	200
	985,838	**965,372**
Non-cash balances related to operations		
Working capital	23,035	26,116
Accrued benefit obligation	5,850	1,018
	1,014,723	**992,506**
Cash used for investment activities		
Purchase of capital assets	(75,062)	(55,735)
Proceeds from sale of capital assets	1,616	376
	(73,446)	**(55,359)**
Cash used for financing activities		
Dividend paid to Province of Ontario	(970,000)	(901,000)
Payment to municipalities on behalf of the Province of Ontario	(5,000)	(4,000)
	(975,000)	**(905,000)**
Increase (decrease) in cash during the year	(33,723)	32,147
Cash and cash equivalents, beginning of year	80,108	47,961
Cash and cash equivalents, end of year	**46,385**	**80,108**

See accompanying notes to financial statements.

1. Nature of the Corporation

The Liquor Control Board of Ontario (Board) is a corporation without share capital incorporated under the *Liquor Control Act*, R.S.O. 1990, Chapter L.18. The corporation is a government enterprise responsible for regulating the production, importation, distribution and sale of alcoholic beverages in the Province of Ontario. As an Ontario Crown Corporation, the Board is exempt from income taxes under Section 149(1)(d) of the *Canadian Income Tax Act*. The Board transfers most of its profits to the Province of Ontario's Consolidated Revenue Fund in the form of a dividend.

2. Significant Accounting Policies

(a) Basis of Accounting

The Board's financial statements are prepared in accordance with Canadian generally accepted accounting principles.

(b) Inventories

Inventories are valued at the lower of cost and net realizable value with cost being determined by the moving average cost method.

(c) Capital Assets

Major capital expenditures with a future useful life beyond the current year are capitalized at cost and are amortized on a straight-line basis according to their estimated useful lives, as follows:

Buildings	20 years
Furniture and Fixtures	5 years
Leasehold Improvements	5 years
Computer Equipment	3 years

Minor capital expenditures and the expenditures for repairs and maintenance are charged to income.

(d) Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(e) Cash and Cash Equivalents

Cash and cash equivalents comprise cash and highly liquid investments with original maturity dates of less than 90 days.

The Board's investment policy restricts short-term investments to high liquidity, high grade money market instruments such as federal/provincial treasury bills, banker's acceptances and term deposits.

3. Accrued Benefit Obligation

The accrued benefit obligation includes accruals for employee termination payments and unfunded workers' compensation obligation.

In fiscal 2003, the cost of these employee future benefits was $8.7 million (2002 – $5.8 million) and is included in Cost and expenses in the Statement of Income and Retained Income. The accrued benefit obligation as at March 31, 2003 is $37.4 million (2002 – $31.5 million) of which $4.5 million (2002 – $3.5 million) is classified as a current liability.

The cost of post-retirement, non-pension employee benefits is paid by Management Board Secretariat and is not included in the Statement of Income and Retained Income.

4. Pension Plan

The Board provides pension benefits for all its permanent employees (and to non-permanent employees who elect to participate) through the Public Service Pension Fund (PSPF) and the Ontario Public Service Employees' Union Pension Fund (OPSEU Pension Fund), which are multi-employer defined benefit pension plans established by the Province of Ontario. These plans are accounted for as defined contribution pension plans as the Board has insufficient information to apply defined benefit plan accounting. The expense represents the Board's contributions to the plans during the year.

In fiscal 2003, the expense was $11.1 million (2002 – $10.1 million) and is included in Cost and expenses in the Statement of Income and Retained Income.

5. Capital Assets

(in $000's)	2003			2002
	[illegible]	Accumulated Amortization	[illegible]	[illegible]
Land	13,584	—	13,584	13,737
Buildings	294,354	201,186	93,168	92,704
Furniture and fixtures	55,139	32,600	22,539	12,628
Leasehold improvements	156,782	94,513	62,269	45,097
Computer equipment	120,895	87,410	33,485	33,729
	640,754	**415,709**	**225,045**	**197,895**

6. Lease Commitments

The Board is committed under operating leases on leased premises with future minimum rental payments due as follows:

	(in $000s)
2004	32,411
2005	30,739
2006	28,487
2007	26,518
2008	23,982
Thereafter	181,468
	323,605

7. Hedging

The Board has entered into forward foreign exchange contracts to manage the foreign exchange risk associated with its purchases from foreign suppliers. A forward foreign exchange contract is an agreement between two parties to set exchange rates in advance.

As at March 31, 2003 the Board had $4,448,340 (2002 – $3,702,693) forward foreign exchange contracts outstanding.

Credit risk is the risk that a party to a forward foreign exchange contract will fail to discharge its obligation and cause the Board to incur financial loss. The Board minimizes credit risk by only dealing with major Canadian chartered banks and Canadian subsidiaries of major foreign banks.

8. Contingencies

The Board is involved in various legal actions arising out of the ordinary course and conduct of business. The outcome and ultimate disposition of these actions are not determinable at this time. Accordingly, no provision for these actions is reflected in the financial statements. Settlements, if any, concerning these contingencies will be accounted for in the period in which the settlement occurs.

9. Payment to Municipalities

During fiscal 2003, in accordance with Section 5(2) of the *Liquor Control Act*, 1990, the Board was directed by Cabinet to contribute $5 million (2002 - $4 million) to assist municipalities with their glass recycling costs. Cabinet further directed the Board to contribute $5 million annually in each of the next three years.

Board Members

Members of the LCBO Board, like those of other government agencies, boards and commissions, are appointed by the sitting government through orders-in-council. Appointments, up to five years, are sometimes renewed.

ANDREW S. BRANDT:
Appointed Chair and Chief Executive Officer February 6, 1991. Term expires February 2006.

Re-appointed in 2003 for a fifth three-year term as Chair and CEO, Mr. Brandt came to the LCBO after a long and distinguished career in the private and public sectors. He began his public-service career in Sarnia, where he served on City Council for almost a decade, including three terms as mayor. In 1981, he was elected to the Ontario Legislature as MPP for Sarnia and in 1987 was named Leader of the Ontario Progressive Conservative Party, a post he held until 1990. In the private sector, Mr. Brandt ran a successful wholesale and retail musical instrument business for many years. He is also an active and award-winning volunteer in several community organizations, including the United Way, Rotary Club, Kiwanis Club and Lambton College Foundation. During his tenure as Chair and CEO, Mr. Brandt has played a key role in the transformation of the LCBO from staid government bureaucracy to award-winning retailer, reflected in eight straight record dividend transfers to the Government of Ontario.

THOM A. BENNETT:
Appointed October 11, 2000. Term expires October 2003.

President and owner of Bennett Insurance Agency Ltd., Mr. Bennett is a seasoned senior executive with a business management background and expertise in the field of employee benefits. He has served as Chair of the Ontario Video Lottery Corporation and Vice-Chair of the Ontario Lottery Corporation, where he took part in a major restructuring program designed to enhance efficiency and profitability. A resident of Ottawa, he sits on the Board of Directors of the University of Ottawa Heart Institute; has coached little league baseball in Nepean; has served as Secretary of the Kiwanis Club of South Ottawa; and was a Cub Leader with the Boy Scouts of Canada.

GAYLE CHRISTIE:
Appointed June 13, 2001. Term expires June 2004.

Ms. Christie is a Toronto government relations consultant who advises private-sector clients on how to work with municipalities, drawing on her experience as a former trustee, councillor and mayor of the city of York, which was amalgamated into Toronto in 1997. As mayor of York from 1978-82, she established the city's first internal audit committee and instituted other reforms to increase productivity and accountability. She then spent eight years with accounting firm Clarkson Gordon (now part of Ernst & Young), further developing her skills. In addition to her consultancy, she sits on several boards, including Humber River Regional Hospital, Runnymede Chronic Care Hospital and Yorktown Community Services.

BEV HAMMOND:
Appointed September 26, 2002.
Term expires September 2005.

Bev Hammond is President of Veritas Communications, a Toronto firm that counsels clients on public, investor and government relations. Before joining Veritas, she combined her agency work with extensive experience as a political communications advisor. She has been a senior advisor to the federal Minister of Small Business, Tourism and International Trade, as well as Communications Director and Press Secretary to Ontario's Deputy Premier and Minister of Finance, and Executive Assistant to the Government House Leader. She was Media Director and Strategic Advisor on Premier Ernie Eves' leadership campaign in 2002. She serves on the boards of Food Buddies and Special Olympics Canada, and is a member of the Canadian Investor Relations Institute (CIRI), the Toronto Board of Trade and the advisory board for the CHSRF Chair in Nursing Human Resources.

JOHN C. HOPPER:
Appointed September 8, 1997.
Term expires September 2003.

A native of Ottawa, Mr. Hopper is President and Dealer Principal of Hopper Automobile Ltd., and President of Saturn of North Bay. A former North Bay City councillor, he has a long history of community service: he is a member of the Masonic Lodge; a member and past president of both the Rorab Shrine Club and North Bay Kiwanis Club; a member of the Northern Ontario Cancer Research Foundation; a Governor of Thorneloe University in Sudbury; and he chaired the fundraising campaign for North Bay's new General Hospital while serving on its Advisory Board. He was the Kiwanis Club's Citizen of the Year in 1993. In 1998, he was elected a Mel Osbourne Fellow to the Kiwanis Foundation of Canada.

DR. MERLE A. JACOBS:
Appointed December 17, 1997.
Term expires December 2003.

Dr. Jacobs' professional experience and studies have shared a focus on mental health, as does much of her extensive volunteer work. Now an Assistant Professor in York University's Department of Sociology, she has served on the Board of Toronto's Queen Street Mental Health Centre and is a member of the Registered Nurses Association of Ontario's Mental Health Interest Group, as well as its Policy Committee. She is a director of Roots Cultural Foundation and Royal Business Training Centre. As a practising nurse psychotherapist and owner of The Lawrence Centre, Dr. Jacobs has also developed her business planning and budgeting skills, as well as her knowledge of human resources issues. She recently edited *Women at the Margins: Is Anyone Listening?*, a reader focusing on gender equality in the workplace and in society.

PERRY MIELE:
Appointed April 3, 2002.
Term expires April 2005.

Chair and Partner of Financial Task Force Inc., a Canadian merchant banking firm in Toronto, Mr. Miele has extensive senior-level experience as a strategic builder of businesses across a broad range of categories. After serving as chief of staff to the Hon. Pat Carney during NAFTA negotiations, he joined integrated marketing services company Gingko in 1987 as a partner and quickly helped the firm to grow. The company merged with Draft-Worldwide of Chicago in 1988 and he became President of the International Group, responsible for operations in 24 countries. Well versed in consumer insight and research methodology, Mr. Miele has worked in every marketing discipline, including advertising, sales promotion, public relations, direct marketing, telemarketing and digital marketing.

Useful Facts

For the fiscal year ended March 31, 2003, unless otherwise noted

The Marketplace

597	Number of LCBO stores serving communities across Ontario
155	Number of LCBO agency stores serving Ontario communities without large enough populations to support a regular LCBO store or Beer Store
876	Number of Beer Stores, Ontario winery stores, on-site distillery and brewery outlets and privately operated duty-free stores in Ontario
45.5	Percentage share of Ontario beverage alcohol market, in dollar value, held by the LCBO
$7.9 billion	Total estimated value of Ontario's beverage alcohol market
$456 million	Estimated value of Ontario's illegal alcohol market

Our Stores

71	Number of LCBO stores offering more than 2,500 brands for sale
144	Number of LCBO stores offering 1,500-2,500 brands for sale
150	Number of LCBO stores offering 1,000-1,500 brands for sale
205	Number of LCBO stores offering 500-1,000 brands for sale
27	Number of LCBO stores offering fewer than 500 brands for sale
14,439	Number of product tastings conducted in LCBO stores
1	Percentage of customers in a February 2003 survey who said they were dissatisfied with service in LCBO stores
97 million	Total number of transactions in LCBO stores
30.1	Percentage of all LCBO transactions paid by debit card
25.5	Percentage of all LCBO transactions paid by credit card

Our Financial Performance

$3.1 billion	The LCBO's net sales and other income
$975 million	Dividend the LCBO transferred to the Government of Ontario (excluding taxes)
$4.3 billion	Amount the LCBO has transferred the last five fiscal years combined (excluding taxes)
353	Percentage return on taxpayers' equity in 2002–03
30.3	The LCBO's profit margin, expressed as a percentage
16.7	The LCBO's operating expenses as a percentage of net sales
$289 million	Amount the LCBO transferred to the provincial government in Provincial Sales Tax (PST)
$392 million	Amount the LCBO transferred to the federal government in GST, excise taxes and customs duties
$46.6 million	Amount the LCBO spent on capital improvements to its stores (renovations, relocations, etc.)

Products and Pricing

13,656	Total number of products available through LCBO stores, catalogues and private ordering service
3,127	Number of VINTAGES products offered in stores and through the *Classics Catalogue* and other programs
65	Number of countries from which the LCBO bought products
1,180	Number of products discounted by up to 20 per cent through the LCBO's Limited Time Offer program
1,173	Number of products that carried a "value-add" bonus item
883	Number of products with bonus AIR MILES Rewards

81	Percentage of domestic spirit prices made up of federal and provincial taxes, levies and mark-ups
60	Percentage of domestic wine prices made up of federal and provincial taxes, levies and mark-ups
54	Percentage of domestic beer prices made up of federal and provincial taxes, levies and mark-ups

Our Employees

1,321	Number of Retail employees who received social responsibility training to help prevent service to minors or people who appear intoxicated
328	Number of Retail employees who passed the highest level of our three-level Product Knowledge Course this year
1,112	Number of Retail employees who passed the LCBO Service Knowledge Course this year
88,953	Number of calls handled by LCBO Infoline officers
6,984	Number of e-mails handled by LCBO Infoline officers

Our Fundraising

998	Number of employees who contributed to the LCBO United Way campaign in calendar 2002
$130,000	Total amount raised by employees through donations and special events
$238,000	Amount raised for charity through donation boxes in LCBO stores in calendar 2002 (Note: This does not include funds raised for local charities in January and June, or funds raised by the Royal Canadian Legion in November.)

Social Responsibility

1,123,703	Number of customers challenged for proof of age or sobriety by LCBO staff
69,949	Number refused service
4,394	Number of BYID tamper-resistant identification cards issued by the LCBO
24,015	Total number of BYID cards issued as of March 31, 2003

Quality Assurance

343,289	Number of product tests carried out by LCBO's Quality Assurance laboratory
1,098	Number of products rejected by Quality Assurance for health concerns, consumer safety issues and other quality control problems
355	Number of seized products tested for enforcement purposes by Quality Assurance
4	Number of product recalls issued by Quality Assurance

$3.1 billion sal

$975 million dividend

1.1 million challenged

70,000 refused

LCBO

responsible

innovative

engaging

knowledgeable

For information about LCBO products and services,
visit us on the Internet at:
www.lcbo.com and www.vintages.com